



Interim Prudential sourcebook: Investment businesses

The Interim Prudential Sourcebook for Investment Businesses

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Transitional provisions

1 Table Transitional provisions applying to IPRU(INV)

(1)	(2) Material to which the transitional provision applies	(3)	(4) Transitional provision	(5) Transitional provision: dates in force	(6) Handbook provision: coming into force
1			[Deleted: material moved to UPRU]	[Deleted: material moved to UPRU]	[Deleted: material moved to UPRU]
2			[Deleted]	[Deleted]	[Deleted]

INTERIM PRUDENTIAL SOURCEBOOK FOR INVESTMENT BUSINESSES

1 Chapter 1: Application and General Provisions

1.1 PURPOSE

- 1.1.1 G Before 1 January 2007, the Interim Prudential Sourcebook for Investment Businesses (*IPRU (INV)*) was the part of the *Handbook* that dealt with capital requirements for *investment firms* subject to the position risk requirements of the previous version of the *Capital Adequacy Directive*. Now, however, *investment firms* which are subject to the risk-based capital requirements of the *Capital Adequacy Directive* are subject to the General Prudential sourcebook (*GENPRU*) and the Prudential sourcebook for Banks, Building Societies and Investment Firms (*BIPRU*). However the *FSA* has not yet removed the parts of *IPRU(INV)* that deal with requirements for *firms* subject to risk-based capital requirements of the previous version of the *Capital Adequacy Directive*. Consequently, many provisions of *IPRU(INV)* will not apply to any *firm*. The *FSA* intends to remove these provisions in due course.
- 1.1.2 G The *rules* and *guidance* in this sourcebook will assist the *FSA* to meet the statutory objectives of protecting consumers and maintaining market confidence. This sourcebook does so by setting minimal capital and other risk management standards thereby mitigating the possibility that *firms* will be unable to meet their liabilities and commitments to *consumers* and counterparties.
- 1.1.3 G The general scheme of this sourcebook is, wherever appropriate, to apply the financial and other prudential standards which applied to a *firm* immediately prior to it becoming authorised by the *FSA* under the *Act*. For convenience, the chapter numbers adopted in this sourcebook correspond with those of the rulebooks of *previous regulators*.
- 1.1.3A G This sourcebook does not apply to *BIPRU* investment firms except as provided in chapter TP of *BIPRU* applying parts of *IPRU(INV)* to certain *BIPRU investment firms* on a transitional basis.
- 1.1.4 G This sourcebook does not apply to *banks, building societies, insurers, the Society of Lloyd's* (except in relation to *underwriting agents*), *friendly societies* and certain other categories of *firm* and *members' advisers*.
- 1.1.5 G On becoming authorised by the *FSA* a *firm* will have to comply with the particular chapter of this sourcebook appropriate to its business. The *firm* will be able to seek guidance on this during the authorisation procedure. If subsequently, the business for which a *firm* has *permission* changes it may be necessary for it to comply with a different set of financial resources requirements. *Firms* will be able to discuss this aspect with the *FSA* during the application process.
- 1.1.6 G The *Supervision manual* sets out provisions relating to the periodic reporting and notification of financial information to the *FSA* or to the auditing of accounts. However, this sourcebook contains a few additional notification requirements (*notification rules*).

1.2 APPLICATION

1.2.1 R The Glossary applies to the transitional provisions, this chapter (*IPRU(INV) 1*), *IPRU(INV) 2*, *IPRU(INV) 4* and *IPRU(INV) 6*.

1.2.2 R (1) *IPRU (INV)* applies to:

- (a) a *members' adviser*;
- (b) an *investment management firm*;
- (c) a *personal investment firm*;
- (d) an *authorised professional firm*;
- (e) a *securities and futures firm*;
- (f) a *service company*;
- (g) the *Society of Lloyd's* (in relation to *underwriting agents*); and
- (h) [deleted]
- (i) a *credit union* which is a *CTF provider*.

(2) *IPRU (INV)* does not apply to:

- (a) a *lead regulated firm*; or
- (b) a *media firm*;
- (c) a *BIPRU investment firm*.

(3) The definitions in the *Glossary* (which is applicable to the *Handbook* generally) apply to this chapter.

1.2.3 G For the avoidance of doubt, *IPRU (INV)* does not apply to any of the following:

- (a) a *bank*; or
- (b) a *building society*; or
- (c) a *friendly society*; or
- (d) an *ICVC*; or
- (e) an *incoming EEA firm* or an *incoming Treaty firm* which does not have a *top up permission*; or
- (f) an *insurer*; or
- (g) a *UCITS* qualifier; or.
- (h) a *UCITS management company*

OBLIGATION TO COMPLY

1.2.4 R A *firm* of a kind listed in the left-hand column of Table 1.2.4R must comply with the provisions of *IPRU (INV)* shown in the right hand column and, where relevant, the provisions of Chapter 14.

1.2.5 R Table

This table belongs to *IPRU (INV)* 1.2.4R

<i>Professional firm</i>	Chapters 1 and 2
<i>Securities and futures firm (which is not an ISD investment firm) or a category D firm (as defined in IPRU (INV) 10 App1)</i>	Chapters 1 and 3
<i>The Society of Lloyd's (in relation to underwriting agents) and members' advisers</i>	Chapters 1 and 4
<i>Investment management firm</i>	Chapters 1 and 5
<i>Service company</i>	Chapters 1 and 6
<i>Securities and futures firm (which is also an ISD investment firm) or a category D firm (as defined in IPRU (INV) 10 App1)</i>	Chapters 1 and 10
<i>Personal investment firm</i>	Chapters 1 and 13
<i>Credit union which is a CTF provider</i>	Chapters 1 and 8

CAPITAL SUBSTITUTES: TRANSITIONAL PROVISION

1.2.6 G The financial resource requirements of the Financial Services Act regulators permitted certain types of borrowings or facilities to be treated as part of a *firm's* capital resources. The most common example is that of a subordinated loan which met the relevant conditions. The following provisions permit *firms* to continue to use these borrowings or facilities in the same way as under the relevant *previous regulator's* rules, provided that certain conditions are met.

1.2.7 R (1) If a *firm* was, immediately before *commencement* permitted to treat "relevant funds" as part of its capital resources under the financial resource rules of a *previous regulator* applicable to the *firm*, it may treat those funds in an equivalent manner under the corresponding provisions of *IPRU (INV)*, provided that the conditions in (3) are met.

- (2) For the purposes of this *rule* “relevant funds” are funds provided to the *firm* under the terms of
- (a) a subordinated loan agreement; or
 - (b) qualifying undertaking; or
 - (c) any other instrument treated in an equivalent manner under the financial resources *rules* applicable to the *firm*.
- (3) The conditions referred to in (1) are either:
- (a) in the case of a subordinated loan agreement, qualifying undertaking or other relevant instrument to which the *firm’s previous regulator* is not party:
 - (i) the parties to it treat all rights (including, without limitation, rights to notice) which the agreement, undertaking or instrument grants to the *firm’s previous regulator* as having been granted to the *FSA*; and
 - (ii) if there is a variation of the commercial terms the parties include, in the terms of the instrument executed to effect the variation, provision to substitute reference to the *FSA* in place of any reference to the *firm’s previous regulator*; or
 - (b) in the case of a subordinated loan agreement, qualifying undertaking or other relevant instrument to which the *firm’s previous regulator* is party, the parties treat the rights accorded to the self regulating organisation under the relevant instrument as having been assigned to the *FSA* immediately before *commencement*.

1.2.8 G An instrument treated in an equivalent manner would, for example, include (in relation to a *personal investment firm*) a “PASS loan”.

2 Chapter 2: Professional firms

2.1 Application

- 2.1.1 R (1) This chapter applies to an *authorised professional firm* in accordance with *IPRU (INV)* 2.1.2R and 2.1.3R.
- (2) The definitions in the *Glossary* annexed to the General Provisions Instrument 2001 (which is applicable to the *Handbook* generally) apply to this chapter.
- 2.1.2 R (1) An *authorised professional firm* of a kind falling within (2) must comply with such of *IPRU (INV)* 3, 5, 10 or 13 which in accordance with *IPRU (INV)* 2.1.4R, most appropriately correlates to the type and scale of the business which it conducts.
- (2) The type of *authorised professional firm* to which (1) applies is one:
- (a) which is also an *ISD investment firm*;
 - (b) which acts as a *market maker*;
 - (c) which acts as a *stabilising manager*;
 - (d) which acts as the trustee or operator of a *regulated collective investment scheme*;
 - (e) which acts as a *broker fund adviser* or otherwise participates in a *broker fund* arrangement;
 - (f) whose main business, having regard to (3), is not the practice of its profession or professions;
 - (g) whose *permission* includes a requirement that it acts in conformity with the financial resources *rules* applicable to another type of *firm*; or
 - (h) whose *permission* includes *establishing, operating or winding up a personal pension scheme*.
- (3) For the purposes of (2)(f), a *firm's* professional business practice is not the "main business" of the *firm* unless the proportion of income it derives from *professional fees* is, during its annual accounting period, at least 50% of the *firm's* total income (a temporary variation of not more than 5% may be disregarded for this purpose).

(4) An *authorised professional firm* which, in accordance with (1), is required to comply with *IPRU (INV) 3, 5, 10 or 13* must immediately give notification of that fact to the *FSA* in accordance with *SUP 15.7* (Forms and method of notification).

2.1.3 R An *authorised professional firm* which does not fall within *IPRU (INV) 2.1.2R* must comply with sections 2.2, 2.3 and 2.4 of this chapter.

2.1.4 R This table belongs to *IPRU (INV) 2.1.1R*

TYPE OF BUSINESS ACTIVITY	CHAPTER OF SOURCEBOOK
<p>(i) <i>managing investments</i> other than for <i>private customers</i>; or</p> <p>(ii) <i>OPS activity</i>; or</p> <p>(iii) acting as the manager or trustee of an <i>AUT</i>; or</p> <p>(iv) acting as the <i>ACD</i> or <i>depository</i> of an <i>ICVC</i>; or</p> <p>(v) <i>establishing, operating or winding-up</i> other <i>collective investment schemes</i>; or</p> <p>(va) <i>establishing, operating or winding up</i> a <i>personal pension scheme</i>; or</p> <p>(vi) <i>safeguarding and administering investments</i>;</p>	<p><i>Investment management firm - IPRU (INV) 5</i></p>
<p>(i) <i>advising on, or arranging deals in, packaged products</i>; or</p> <p>(ii) <i>managing investments</i> for <i>private customers</i>;</p>	<p><i>Personal investment firm - IPRU (INV) 13</i></p>
<p>(i) a <i>regulated activity</i> carried on as a member of an <i>exchange</i>; or</p> <p>(ii) acting as a <i>market maker</i> in <i>securities</i> or <i>derivatives</i>; or</p>	<p><i>Securities and futures firm - IPRU (INV) 10 (ISD firm); or</i></p> <p><i>Securities and futures firm - IPRU (INV) 3 (non ISD firm)</i></p>

iii) corporate finance business; or	
(iv) dealing or arranging deals in securities or derivatives, other than inter-professional investments; or	
(v) the provision of clearing services as a clearing firm; or	
(vi) spread betting;	

2.1.5 G An *authorised professional firm* will be an *ISD investment firm* if its business activities include the provision of a *core investment service* for a third party. An *authorised professional firm* will not however be an *ISD investment firm* if it falls within one of the exclusions contained in paragraph 2 of Article 2 of the directive. Paragraph 2(c) of Article 2 provides an exclusion for an *authorised professional firm* which provides *core investment services* in an incidental manner in the course of a professional activity (provided that activity is regulated by the *firm's designated professional body*).

2.1.6 G The *FSA* considers the scope of this exclusion cannot be precisely defined. Ultimately questions of interpretation are for the Court to determine. The *FSA* considers that to satisfy the exclusion the services cannot be the major part of the practice of the *firm*. The *FSA* also considers the following factors to be among those that are relevant:

- (1) the scale of *regulated activity* in proportion to other professional services provided;
- (2) whether and to what extent activities that are *regulated activities* are held out as separate services;
- (3) the impression given as to how the *firm* provides *regulated activities*, for example through its advertising or other promotions of its service.

2.2 Financial Resources Requirements

- 2.2.1 R (1) **A *firm* must be able to meet its liabilities as they fall due.**
- (2) **In complying with (1) a *firm* may use any assets which are available to meet any of its liabilities.**

2.2.2 G *Firms* are reminded that:

- (1) requirements relating to the systems and controls which *firms* must establish and maintain for ensuring compliance with financial resources and other requirements are set out in SYSC.
- (2) the financial reports that a *firm* is required to make to the *FSA* are set out in SUP 16.

2.3 Professional Indemnity Insurance

- 2.3.1 R A firm must effect and maintain at all times adequate professional indemnity insurance cover for all the business activities which it carries on, or for which it is responsible.**
- 2.3.2 G** In assessing the adequacy of a *firms'* professional indemnity insurance cover for the purposes of *IPRU(INV)* 2.3.1R, the *FSA* may have regard to a *firm's* compliance with the professional indemnity insurance requirements of its *designated professional body* in force at the time.

2.4 Bonding Requirement for Accountants

- 2.4.1 R This section applies to a firm of accountants practising as such in the UK.**
- 2.4.2 R** (1) **If the aggregate value of *client money* and *bonded investments* a firm holds for a *client* is over £50,000 then the firm must ensure that it holds a bond for the excess over £50,000.**
- (2) **A firm must:**
- (a) **ensure that the bond is in the form prescribed by the FSA;**
 - (b) **ensure that the person specified to act as trustee in the bond is a *designated professional body* or a solicitor practising as such in the UK;**
 - (c) **ensure that the bond is lodged with the trustee; and**
 - (d) **be able at all times to show that the amount of the bond is sufficient to meet the requirements of (1).**
- 2.4.3 R A firm must notify the FSA immediately:**
- (1) **of any bond taken out specifying the amount and where it is lodged; and**
 - (2) **of the arrangements it has made to comply with *IPRU (INV)* 2.4.2R if a bond is not renewed or is cancelled.**

- 2.4.4 G (1) *Firms* which hold *client money* or *bonded investments* for more than one *client*, may hold one bond to cover all of the *clients* concerned. The bonding requirements may be complied with by taking out a global bond. In firms with numerous offices compliance may be achieved in practice by calculating the requirement based on figures supplied by offices which is likely to be at least quarterly. These figures would need to be supplied and assessed soon after the end of each quarter.
- (2) To ensure the global cover is sufficient, this approach would require an estimated safety margin to be incorporated, to allow for changes in the amounts of *client money*, *investments* or assets held. An additional prudent measure would be to ensure that exceptional amounts of these assets are notified by branch offices so that the *firm* can check whether the safety margin can absorb them and reconsider whether the total global bond cover remains sufficient.
- 2.4.5 G *Firms* which do not expect to hold *bonded investments* or *client money* in excess of the value limit need not hold a bond. However, *firms* may wish to make contingency arrangements with a surety whereby a bond facility is available and can be executed and delivered at short notice.

- 3 Chapter 3: Financial resources for Securities and Futures Firms which are not Investment Firms**
- 3-A R** The definitions in the glossary at Appendix 1 apply to this chapter.
- 3-1 R** This chapter applies to a *securities and futures firm* which is not an *investment firm* or a *category D firm*.
- 3-1A R** This chapter does not apply to an *oil market participant* unless it is a member of a *recognised* or *designated investment exchange* which is, under the rules of that exchange, entitled to trade with other members.
- G An *oil market participant* to which this chapter does not apply is still subject to the requirement of *Principle 4* to have adequate financial resources.
- 3-2 R** A *firm* must at all times have available the amount and type of *financial resources* required by the rules of the *FSA*.
- 3-5 R** A *firm* must notify the *FSA* immediately it becomes aware that it is in breach of, or that it expects shortly to be in breach of, rule 3-2.
- 3-10** Keeping of records
- Records to be up-to-date
- 3-10(1) R** A *firm* must keep accounting records in accordance with rules 3-10 to 3-13 on a continual basis so that at all times records are up-to-date or able to be brought up-to-date within a reasonable time.
- Adequacy of records
- 3-10(2) R** A *firm* must keep accounting records in such a manner that they are sufficient to show and explain the *firm's* transactions and commitments (whether effected on its own behalf or on behalf of others) and in particular so that these records:
- (a) disclose with reasonable accuracy the financial position of the *firm* at any point in time within the previous six years when the *firm* was a member of the *FSA* or a predecessor regulator;
 - (b) demonstrate whether or not the *firm* is or was at that time complying with its *financial resources requirement*; and

- (c) enable the *firm* to prepare within a reasonable time any *financial reporting statement* as at the close of business of any date within the previous six years when the *firm* was regulated by the *FSA* or a predecessor regulator, and such that the statement complies with the requirements of the rules of the *FSA*.

Content of records

3-10(3)

A *firm* must ensure that its accounting records shall as a minimum contain:

- (a) entries from day to day of all sums of money received and expended by the *firm* whether on its behalf or on behalf of others, and the matters in respect of which the receipt and expenditure takes place;
- (b) a record of all income and expenditure of the *firm* explaining its nature;
- (c) a record of all assets and liabilities of the *firm* including any commitments or *contingent liabilities*;
- (d) entries from day to day of all purchases and sales of *investments* by the *firm* distinguishing those which are made by the *firm* on its own account and those which are made by or on behalf of others;
- (e) entries from day to day of the receipt and dispatch of *documents of title* which are in the possession or control of the *firm*; and
- (f) a record of all *investments* or *documents of title* in the possession or control of the *firm* showing the physical location, the beneficial owner, the purpose for which they are held and whether they are subject to any charge.

- G The *FSA* does not consider it possible to prepare an exhaustive and prescriptive list of record keeping requirements applicable to all *firms*. The detailed requirements will vary according to the manner in which the business is structured, organised and managed; its size; and the nature, volume and complexity of its transactions and commitments. The overriding principle, however, is that the records and systems must be adequate to fulfil the general requirements set out in rule 3-10.

3-11 Reconciliation of firm's balances

Reconciliation

- 3-11(1)** R (b) **A firm must reconcile all balances and positions with exchanges, approved exchanges, clearing houses and intermediate brokers as recorded by the firm to the balance or position on a statement or circularisation obtained by the firm from the exchange etc and must correct any differences by agreement with the exchange etc on a timely basis.**
- (c) **A firm must perform reconciliations under (b) above as frequently as is appropriate for the volume of transactions on the accounts and in any event not less than once every five weeks.**
- (d) **A firm must reconcile all balances and securities positions with each market counterparty which is a member of an exchange or approved exchange as recorded by the firm to the balance or position on a statement or circularisation obtained by the firm from the market counterparty except to the extent that the balances and securities positions due to and from the market counterparty have been agreed by other means, and must correct any differences by agreement with the market counterparty on a timely basis. ***
- (e) **A firm must perform reconciliations under (d) above as frequently as is appropriate for the volume of transactions on the accounts and in any event not less than once every year.**

Circularisation

- 3-11(2)** **A firm must circularise or request statements from banks, building societies, exchanges, approved exchanges, clearing houses, intermediate brokers and market counterparties which are members of exchanges or approved exchanges in good time in order to be able to comply with (1) above.**

Response to requests

- 3-11(3)** **A firm must use its best endeavours to respond within one month of receipt to any circularisation from another firm requesting confirmation of outstanding balances.**

* For guidance notes on the reconciliation of a firm's balances with market counterparties see, **Appendix 20**

3-12 Risk management and internal control

Exposure limits

- 3-12(1) R** **A *firm* must ensure that its accounting and other records contain details of exposure limits for trading positions, and for commitments under its *ACMP*, which are appropriate to the type, nature and volume of business undertaken and that the information contained in the records is capable of being summarised in such a way as to enable actual exposures to be measured readily and regularly against these limits.**

Management information

- 3-12(2) R** **A *firm* must maintain its records in a manner such that they disclose, or are capable of disclosing, in a prompt and appropriate fashion, the financial and business information which will enable the *firm's* management to:**
- (a) identify, quantify, control and manage the *firm's* risk exposures;**
 - (b) make timely and informed decisions;**
 - (c) monitor the performance of all aspects of the *firm's* business on an up-to-date basis;**
 - (d) monitor the quality of the *firm's* assets; and**
 - (e) safeguard the assets of the *firm*, including assets for which the *firm* is responsible belonging to *customers* and other persons.**

3-13 Nature, accessibility and retention of records

Nature of records

- 3-13(1) R** **(a) A *firm* may keep a record in a form other than a document or copy of a document provided that the record can be reproduced in hard printed form.**
- (b) Where all the records relating to a *counterparty* are not kept together, a *firm* must ensure that each location where documents relating to that *counterparty* are retained contains an indication that other records relating to that *counterparty* exist and how access to them can be obtained.**

- (c) **A *firm* may accept and rely on records supplied by a third party so long as those records are capable of being and are reconciled with records held by the *firm*.**
- (d) **A *firm*'s records must generally be in English but may be in another language if the *firm* has facilities for producing a translation of the record into English within a reasonable time of any request for production of such a translation being made by the *FSA* or the *firm*'s auditor or *reporting accountant*.**

Audit trail

- 3-13(3) A *firm* must record the information required by rules 3-10 to 3-13 in such a way as to enable a particular transaction to be identified at any time and traced through the accounting systems of the *firm*, in particular in such manner as to enable early identification of aggregates and of the particular items which have contributed to those aggregates.**

Prompt access

- 3-13(3) R A *firm* must ensure that all records are arranged, filed and indexed so as to permit prompt access to any particular record.**

Retention of records

- 3-13(4) R**
- (a) **A *firm* must keep all records required by rules 3-10 to 3-13 as well as any working papers necessary to show the preparation of any *reporting statement* or any other periodic return to the *FSA*.**
 - (b) **A *firm* must keep these records and working papers for a period of six years after the date on which they are first made or prepared.**
 - (c) **During the most recent of those years, a *firm* must keep these records and working papers either at a place where the *firm* carries on business or in such a manner that they can be produced at such a place within 24 hours of their being requested and after the first year in such a manner that they can be produced at a place of business of the *firm* within 48 hours.**

Security of records

- 3-13(5) R A *firm* must maintain adequate procedures for the maintenance, security, privacy and preservation of records, working papers and *documents of title* belonging to the *firm* or others so that they are reasonably safeguarded against loss, unauthorised access, alteration or destruction.**

Valuation of positions *

- 3-41(9) R** A *firm* must value a position on a prudent and consistent basis, as well as having regard to the liquidity of the instrument concerned and any special factors which may adversely affect the closure of the position, and must adopt the following general policies:
- (a) a position must be valued at its close out price (close out price means that a long position shall be valued at current bid price and a short position at current offer price); where firm two way prices are not available a *firm* must value its position in accordance with the notes to this rule; *
 - (b) where a *firm* is entitled to use a risk assessment model in the calculation of its *PRR* on *options* positions, it may value its *options* using the values derived from the model;
 - (c) where a *firm* does not use a model as described in (b) above and prices are not published for its *options* positions, a *firm* must determine the *mark to market* value as follows:
 - (i) for purchased *options*, the *mark to market* value must be the product of:
 - (aa) the *in the money* amount; and
 - (bb) the quantity underlying the *option*;
 - (ii) for written *options* the *mark to market* value must be the initial premium received for the *option* plus the product of:
 - (aa) the amount by which the current *in the money* amount exceeds either the *in the money* amount at the time the contract was written, or zero if the contract was *out of the money* at the time it was written; and
 - (bb) the quantity underlying the *option*;
 - (d) a *firm* must calculate the value of a *swap* contract or an *FRA* having regard to the net present value of the *future* cash flows of the contract, using current interest rates relevant to the periods in which the cash flows will arise;

* For notes on the valuation of positions, see Appendix 21

- (e) notwithstanding (d) above, a *firm* may refrain from marking a *swap* or an *FRA* to market where it enters into such transactions on a matched principal basis, provided that it is confident that such positions are fully matched;**
 - (f) a *firm* that is a partnership which experiences *exceptional* administrative or technical difficulties complying with the valuation procedure outlined above should notify the *FSA* immediately; and**
 - (g) in the case of interest rate *swaps*, currency *swaps* and *FRAs*, a *firm* may limit the bid/offer valuation required under (a) to its net position.**
- G The *FSA* does not lay down a precise formula for calculating the value of *swaps* and *FRAs* for the purposes of this rule. However, it will expect a *firm* to employ a valuation formula which accords with generally accepted market practice.
- G The *FSA* may permit by modification or waiver of this rule an alternative arrangement if it is satisfied that neither the *firm* nor its *counterparties* will be put at risk by the adoption of that alternative procedure.

3-60 FIRMS TO WHICH RULES 3-61 TO 3-182 APPLY

Broad scope firms

- 3-60(1)** R Rules 3-61 to 3-182 apply to a *broad scope firm* except that rules 3-80 to 3-178 do not apply to a *venture capital firm*.

Arrangers

- 3-60(2)** R Rules 3-61 to 3-182 apply to an *arranger*, except that:

- (a) Rule 3-61 and rules 3-63 to 3-182 do not apply to a *corporate finance advisory firm* or a *derivative fund manager*; and
- (b) rules 3-80 to 3-178 do not apply to a *venture capital firm*.

Corporate finance advisory firms

- 3-60(3)** R Rule 3-61 and rules 3-63 to 3-182 do not apply to a *corporate finance advisory firm* which must instead comply with the following two capital requirements at all times:

- (a) *tangible net worth* must exceed £10,000; and
- (b) net current assets (as calculated for the purposes of producing a balance sheet in accordance with Format 1 of the Balance Sheet Format of Schedule 4 to the Companies Act 1985) must exceed £10,000.

Advisers and locals/traded options market makers

- 3-60(4)** R Rules 3-61 to 3-182 do not apply to an *adviser* or *local/traded options market maker* which must instead comply with the following capital requirements at all times:

- (a) *tangible net worth* must be positive;
- (b) in the case of an *adviser*, net current assets (as calculated for the purposes of producing a balance sheet in accordance with Format 1 of the Balance Sheet Format of Schedule 4 to the Companies Act 1985) must be positive; and
- (c) in the case of a *local/traded options market maker*, the *firm* must be able to meet its liabilities as they fall due.

Derivative fund managers

- 3-60(5)** R Rule 3-61 and rules 3-63 to 3-182 do not apply to a *derivative fund manager* which must instead comply with the following two capital requirements at all times:

- (a) ***tangible net worth* must exceed £10,000; and**
- (b) **net current assets (as calculated for the purposes of producing a balance sheet in accordance with Format 1 of the Balance Sheet Format of Schedule 4 to the Companies Act 1985), excluding investment in any pooled fund or *unregulated collective investment scheme* which it manages, must exceed £10,000.**

Dematerialised instruction transmitters

3-60(6) R Rules 3-61 to 3-182 apply to a *dematerialised instruction transmitter*.

Firms that establish, operate or wind-up personal pension schemes

3-60(7) R Rules 3-61 to 3-182 apply to a *firm* whose *permission* includes *establishing, operating or winding-up a personal pension scheme*.

3-61 THE BASIC COMPUTATION

3-61(1) R A *firm* must, at all times, maintain *financial resources* in excess of its *financial resources requirement*.

3-61(2) R A *firm* must calculate its *financial resources* and its *financial resources requirement* in accordance with the table below and rules 3-62 to 3-182.

R Table 3-61. The basic financial resources calculation

Financial resources	Financial resources requirement
Capital ("A") the sum of - - ordinary share capital - preference share capital - share premium account - profit and loss account - other approved reserves, and - partners' current and capital accounts, and - <i>eligible LLP members' capital</i> Intangible assets and <i>excess LLP members' drawings</i> ("B") $A - B = \textit{tangible net worth}$ ("C")	Primary requirement ("E") the sum of - - base requirement - total liquidity adjustment - charged assets - <i>contingent liabilities</i> - deficiencies in <i>subsidiaries</i>
Eligible capital substitutes ("D") the sum of - - subordinated loans - <i>approved bank bonds</i> - approved undertakings	Total PRR ("F") Total CRR ("G")

$C + D = \text{financial resources}$	$E + F + G = \text{financial resources requirement}$
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3-62 Tangible net worth

Calculation

3-62(1) R A firm must calculate its *tangible net worth* in accordance with table 3-61, subject to (2), (3) and (4) below.

Redeemable shares

3-62(2) R A firm may include redeemable *share capital* as part of *tangible net worth* only if:

(a) the *firm's* memorandum and articles of association or a shareholders' agreement contain provisions that:

(i) redemption may not occur if the *firm's financial resources* after redemption would be less than or equal to 120% of its *financial resources requirement*;

(ii) dividends may not be paid if the *firm's financial resources* after payment would be less than or equal to 120% of its *financial resources requirement*; and

(iii) in the case of a shareholder's agreement, any assignee of the shares is subject to the provisions of the agreement; and

(b) the *firm*, before issuing any preference shares, notifies the *FSA* of its intention to do so.

Notice of redemption

3-62(3) R A firm must provide the *FSA* with six months' written notice of redemption of any of its redeemable shares.

Approved reserves

3-62(4) R A firm may not include reserves other than retained profits as part of *tangible net worth*.

G A *firm* that wishes to include other reserves will need to apply for a modification or waiver of this rule.

Profit and loss account/partners' current and capital accounts

3-62(5) R For the calculation of *tangible net worth*, a *firm* must:

(a) 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;

(b) in respect of a defined benefit occupational pension scheme, derecognise any defined benefit asset.

3-62(6) R A firm may, for the purposes of calculating *tangible net worth*, 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.

3-62(7) G A firm should keep a record of and be ready to explain to its supervisory contacts in the FSA 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*.

3-62(8) R 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.

3-63 Eligible capital substitutes

Calculation

3-63(1) R A firm must calculate its *eligible capital substitutes* in accordance with table 3-61, subject to (2) to (9) below.

Approved eligible capital substitutes

3-63(2) R A firm may treat a subordinated loan, *approved bank bond* or approved undertaking as an *eligible capital substitute* only if it is:

(a) drawn up in accordance with the relevant standard form obtained from the FSA; and

(b) signed by authorised signatories of all the parties.

G If a firm wishes to use a form which differs from the standard form it will need to seek a modification to, or modification or waiver of, this rule.

G A firm may, under the provisions of IPRU(INV) 1.2.5R continue to treat a subordinated loan, bank bond or approved undertaking as an eligible capital substitute if it was entitled to do so immediately prior to the *specified day*, and the other conditions set out in IPRU(INV) 1.2.5R are met.

Approved lenders

3-63(3) R A firm may treat a subordinated loan as an *eligible capital substitute* only if the lender is:

- (a) **the firm's controller;**
- (b) **a regulated banking institution;**
- (c) **an approved person; or**
- (d) **a regulated financial institution.**

G If the *firm* wishes to include as an *eligible capital substitute* a subordinated loan from a lender not within the above list, it will need to apply for a modification or modification or waiver of 3-63.

Notice of repayment and termination

3-63(4) R A firm must provide the FSA with five business days written notice of any repayment, prepayment or termination of a subordinated loan, approved bank bond or approved undertaking, except when the firm's financial resources after payment of interest or principal etc would be less than or equal to 120% of its financial resources requirement, in which case the firm must not repay, prepay or terminate any subordinated loan, approved bank bond or approved undertaking otherwise than in accordance with the terms of the relevant agreement.

Amounts repayable within three months

3-63(5) R A firm may not treat any amount of a subordinated loan which is repayable within three months as an eligible capital substitute.

Limit on eligible capital substitutes

3-63(6) R The total amount of eligible capital substitutes which a firm may take into account in its financial resources must not exceed four times tangible net worth.

Limit on approved bank bonds

3-63(7) R The total of approved bank bonds which a firm may treat as an eligible capital substitute must not exceed:

- (a) **30% of the base requirement; and**
- (b) **CRR on exchange-traded-margined-transactions plus concentrated risk to one counterparty arising from exchange-traded-margined-transactions calculated under rules 3-173A and 3-175.**

Limit on approved undertakings

3-63(8) R A firm may only treat approved undertakings as an *eligible capital substitute* to the extent that its *approved bank bonds* are less than 30% of its base requirement.

Approved undertakings

3-63(9) R A firm may treat an undertaking as an *eligible capital substitute* only if the provider of the undertaking is:

(a) a *regulated banking institution*; or

(b) a *regulated financial institution*;

G A firm that wishes to include an undertaking where the provider is neither of the above, it will need to seek a modification or waiver from the FSA.

PRIMARY REQUIREMENT

Definition of primary requirement - General rule

3-70 R A firm's *primary requirement* is the sum of:

(a) the base requirement calculated in accordance with rule 3-71;

(b) the total liquidity adjustment calculated in accordance with rule 3-75;

(c) charged assets calculated in accordance with rule 3-76;

(d) *contingent liabilities* calculated in accordance with rule 3-77; and

(e) deficiencies in *subsidiaries* calculated in accordance with rule 3-78;

Base requirement - General rule

3-71 R A firm's base requirement is the highest of:

(a) the absolute minimum requirement, calculated in accordance with rule 3-72;

(b) the expenditure requirement, calculated in accordance with rule 3-73; or

(c) the volume of business requirement, calculated in accordance with rule 3-74.

Absolute minimum requirement - General rule

3-72 R A firm's absolute minimum requirement is:

- (a) for an *arranger*: £10,000;
- (b) for a *financial bookmaker*: £50,000;
- (c) for an *agency broker*: £50,000;
- (d) for a *firm* which handles *client money* and assets relating to *marginised transactions* and segregates all *money* received from clients as *client money*: £50,000;
- (e) for a *non clearing floor member*: £50,000;
- (f) for a *broad scope firm* other than one within (b) to (e) above: £100,000; or
- (g) for a *dematerialised instruction transmitter*: £50,000.

3-73 Expenditure requirement

General rule

3-73(1) R A *firm's* expenditure requirement is:

- (a) for an *investment manager*; an *introducing broker* who is not responsible for its *counterparties'* performance; a *venture capital firm* which is an *arranger*; a *model A clearing firm*; a *dematerialised instruction transmitter*; or a *firm* that does not hold *client money* or assets but whose *permission* includes *establishing, operating or winding-up a personal pension scheme*: 6/52nds of relevant annual expenditure; or
- (b) for any other *firm*: 1/4 of relevant annual expenditure.

Calculation of relevant annual expenditure

3-73(2) R Subject to (3), (4) and (5) below, a *firm* must calculate its *relevant annual expenditure* with reference to the *firm's* most recent *annual financial statements*, as follows:

- (a) its total revenue; and
- (b) any loss before taxation;

less the aggregate of the following items:

- (c) profit before taxation;
- (d) *bonuses*;
- (e) *profit shares* and other appropriations of profit, except for fixed or guaranteed remuneration of a partner which is payable even if the *firm* makes a loss for the year;

- (f) **paid *commissions shared*, other than to *employees, directors, half commission men or appointed representatives of the firm*;**
- (g) **fees, brokerage and other charges paid to *clearing houses, exchanges, approved exchanges and intermediate brokers* for the purposes of executing, registering or clearing transactions;**
- (h) **interest payable to *counterparties*;**
- (i) **interest payable on borrowings to finance the *firm's investment business and associated business*; and**
- (j) ***exceptional or extraordinary items*, provided that it first notify the *FSA* in writing of the nature and amount of the item(s) concerned.**

Absence of annual financial statements

- 3-73(3) R If a *firm* does not have *annual financial statements*, it must:**
- (a) **where it has just commenced trading, base its *relevant annual expenditure* on budgeted or other accounts which it submitted to the *FSA* as part of its application; or**
 - (b) **where its accounts do not represent a 12 month period, calculate *relevant annual expenditure* on a proportionate basis agreed by the *FSA*.**

Adjustments to relevant annual expenditure

- 3-73(4) R A *firm* must use a *relevant annual expenditure* adjusted to take account of its circumstances where:**
- (a) **there has been a significant change in the circumstances or activities of the *firm*; or**
 - (b) **the *firm* has a material proportion of its expenditure incurred on its behalf by third parties and such expenditure is not fully recharged to the *firm*.**
- G FSA would for example consider an application to vary a *firm's* permitted activity as a significant change.
- G FSA would consider 10% of a *firm's* expenditure incurred on its behalf by third parties to be material for the purposes of 10-73(4)R.
- G If a *firm* is in any doubt, it should always seek guidance from the FSA.

Recent Authorisation

- 3-73(5) R If a *firm* has not been authorised long enough to have prepared *annual financial statements* after authorisation, it must base its *relevant annual expenditure* on budgeted or other accounts which it submitted to the FSA as part of its application.

Application

- 3-74(1) R The volume of business requirement applies only to a *firm* which settles *marginised transactions for counterparties*.

Marginised transactions

- 3-74(2) R A *firm's* volume of business requirement is 3.5% of the aggregate gross amounts of any initial margin (as calculated in (3) below) of the *firm's counterparties* at the relevant time.

Initial margin

- 3-74(3) R A *counterparty's* initial margin for the purposes of (2) above is the sum of the following amounts:

- (a) in respect of *exchange traded* transactions, the *counterparty's initial margin requirement*; and
- (b) in respect of *OTC* transactions, the amount of margin that the *counterparty* is required by the *firm* to deposit.

- 3-75 Liquidity adjustment

General rule

- 3-75(1) R A *firm's* total liquidity adjustment is the sum of amounts specified as liquidity adjustments below.

Intangible assets

- 3-75(2) R The liquidity adjustment for intangible assets is nil (these must be deducted from capital to arrive at *tangible net worth* under 3-62). Intangible assets do not include a deferred acquisition cost asset.

Tangible fixed assets

- 3-75(3) R The liquidity adjustment for tangible fixed assets is the total net book value of such assets, with the exception of land and buildings used as *security for non recourse loans* or other loans which a *firm* must treat under (4) and (5) below.

Land and buildings used as security for non recourse loans

- 3-75(4) R** The liquidity adjustment for land or buildings used as security for a *non recourse loan* is the difference between the net book value of the land or building and the loan principal outstanding, except where the loan principal outstanding is higher than the net book value in which case there is no liquidity adjustment.

Land and buildings used as security for other loans

- 3-75(5) R** The liquidity adjustment for land or buildings used as security for loans other than *non recourse loans* is the difference between the net book value of the land or building and the lower of:
- (a) 85% of a professional valuation of the land and buildings (which must have been carried out in the last two years); or
 - (b) the principal outstanding,
- except where both (a) and (b) are higher than the net book value in which case there is no liquidity adjustment.

Physical stocks

- 3-75(6) R** The liquidity adjustment for physical stocks is the balance sheet value of such stocks, except for stock positions associated with the *firm's investment business* which are:
- (a) *physical commodities* for which the full contract price has been paid;
 - (b) work in progress and finished goods which result from the processing of *physical commodities*; or
 - (c) raw materials which will be combined with *physical commodities* to produce a finished processed commodity,

in which case there is no liquidity adjustment (but see *PRR* rules).

Investments in connected companies

- 3-75(7) R** The liquidity adjustment for an *investment* in a *connected company* is the balance sheet value of the *investment*, except where the *investment* is a *marketable investment* which is not in a *subsidiary*, in which case there is no liquidity adjustment but such *investment* must be subject to the *PRR* rules.

Other investments

- 3-75(8) R** Other *investments* have no liquidity adjustment but instead are subject to the *PRR* rules.

Prepayments

- 3-75(9) R** The liquidity adjustment for a prepayment is the balance sheet value of that prepayment, except that there is no liquidity adjustment to the extent that it relates to goods and services to be received or performed in the next three months (or six weeks in the case of an *investment manager*; an *introducing broker* who is not responsible for its *counterparties'* performance; a *venture capital firm* which is an *arranger*; or a *model A clearing firm*).

Debtors arising from investment business or dealing activities

- 3-75(10) R** Debtors arising from *investment business* or *dealing activities* have no liquidity adjustment but instead are subject to the *CRR* rules.

Other debtors

- 3-75(11) R** The liquidity adjustment for debtors other than debtors arising from *investment business* or *dealing activities* is the balance sheet value of the debtor, except that there is no liquidity adjustment in the following circumstances:

- (a) amounts due from *connected companies* which are *adequately secured* and are repayable within 90 days;
- (b) unsecured amounts due at the request of the *firm* from a *connected company* which is a *regulated banking institution* within 90 days;
- (c) unsecured amounts due at the request of the *firm* from a *connected company* which is a *regulated financial institution* within seven days;
- (d) having given prior written notice to the *FSA*, unsecured amounts receivable at the request of the *firm* from a *connected company* within seven days under an *approved treasury arrangement*, up to a maximum of the *firm's* excess of *financial resources* over its *financial resources requirement* before taking into account the *approved treasury arrangement*;
- (e) amounts receivable in respect of cash dividends declared by either *exchange traded companies* or *authorised persons* which have been outstanding for 30 days or less from the date the dividends were due to be paid;
- (f) amounts accrued or receivable in respect of interest on *marketable investments* which have been outstanding for 30 days or less from the date the interest was due to be paid;

- (g) amounts receivable on U.K. value added tax which have been outstanding for 30 days or less from the date that the value added tax return was due to be received by HM Customs & Excise; and
- (h) amounts receivable on taxation other than U.K. value added tax which have been agreed with the appropriate tax authorities and have been outstanding for 30 days or less from the date that the amounts were due to be received.

Cash deposits

- 3-75(12) R** The liquidity adjustment for a cash deposit is the balance sheet value of the deposit, except for *qualifying deposits* and those other deposits which are subject to rule 3-180.

Other assets

- 3-75(13) R** The liquidity adjustment for assets other than those specifically stated above is the balance sheet value of the asset concerned. Other assets do not include a *defined benefit asset* or a deferred acquisition cost asset.

Charged assets - General rule

- 3-76 R** A *firm* must calculate the *primary requirement* for charged assets as the aggregate balance sheet value of each asset of the *firm* over which a third party has the right of sale or retention on default by the *firm* except:
- (a) to the extent of any liability of the *firm* plus a reasonable margin in respect of the charged asset; or
 - (b) where the asset is collateral for a transaction which is subject to the *CRR* rules.

Contingent liabilities - General rule

- 3-77 R** A *firm* must calculate a *primary requirement* for each of its *contingent liabilities*.

Deficiencies in subsidiaries - General rule

- 3-78 R** A *firm* must calculate the *primary requirement* for deficiencies in *subsidiaries* as an amount equal to any deficiency in shareholders' funds at any time of a *subsidiary* of the *firm* except to the extent that:
- (a) provision has already been made by the *firm*; or

- (b) the *firm* has already calculated a liquidity adjustment or *CRR* because the deficiency arises or partially arises out of a liability of the *subsidiary* to the *firm*.

SECONDARY REQUIREMENT

Risk Profile

- 3-79(1) R A *firm* must include in its secondary requirement any amount specified in any *requirement* to cover an unusual risk profile

Operational risks

- 3-79(2) A *firm* must include in its secondary requirement any amount specified in any *requirement* to cover the inadequate management of operational risk to which a *firm* is exposed.

- G In assessing whether to impose a *requirement* on a *firm* to cover an unusual risk profile or operational risks, the FSA will consider various criteria. Relevant guidance can be found in sections 4 and 5 of Appendix 48 to IPRU(INV) 10. In addition, the FSA will take into account material group risks to a *firm*, where these have not been captured in a group financial resources test. Secondary requirements may be applied, for example, where there has been a major failure on the part of a *firm* to maintain adequate controls, as a means of providing an additional capital buffer whilst these problems are addressed.

POSITION RISK REQUIREMENT

3-80 GENERAL PRINCIPLES OF PRR

Application

- 3-80(1) R Rules 3-80 to 3-169B apply to any *arranger or broad scope firm*, except a *venture capital firm* or a *corporate finance advisory firm*.**

Obligation to calculate PRR *

- 3-80(2) R A *firm* must calculate a minimum *PRR* in respect of any position according to one of the methods available to it under the rules below, as appropriate, but may calculate a higher *PRR* in any other way at its option.**

- G Notwithstanding the methods available for calculating the *PRR*, a *firm* may, in respect of any individual position, calculate a *PRR* which is more conservative than that calculated under the appropriate rule. However, in that case, the *firm* will need to be able to demonstrate that, in all circumstances, the calculation being employed does give rise to a higher *PRR* for the position.

Frequency of calculation

- 3-80(3) R A *firm* must be able to monitor its *total PRR* on an intra-day basis and must re-calculate it in a full and detailed manner before executing any trade which is likely to increase it to such a level that the *firm's financial resources requirement* might exceed the *firm's financial resources*.**

Marking to market

- 3-80(4) R A *firm* must *mark to market* its positions, whether or not on the balance sheet, in accordance with the valuation rule 3-41(9) at least once every *business day* and more frequently as appropriate.**

Marketable investments

- 3-80(4A) R A *firm* must calculate the *PRR* for any position which is a *marketable investment* as 8% of the *mark to market* value of the position, other than in respect of a derivative (whatever the nature of the underlying instrument) or off balance sheet contract, when the *PRR* is 8% of the value of the notional position underlying the contract.**

* For guidance notes as to which methods to apply, see **Appendix 20**

Non marketable investments

- 3-80(5) R** **A firm must calculate the PRR for any position which is not a marketable investment as 100% of the mark to market value of the position, other than in respect of a derivative (whatever the nature of the underlying instrument) or off balance sheet contract, when the PRR is 100% of the value of the notional position underlying the contract.**

Instruments for which no PRA has been specified

- 3-80(6) R** **A firm must calculate the PRR for any on or off balance sheet position in a marketable investment for which no PRA is specified under the PRR rules as an appropriate percentage of the current mark to market value of any position or notional position underlying the contract and must notify the FSA of the terms of the instrument and the proposed PRR treatment.**

- 3-80(6A) E** (1) In 3-80(6) “an appropriate percentage” is:
- (a) 100%; or
 - (b) A percentage which takes account of the characteristics of the instrument concerned and of discussions with the FSA or a predecessor regulator;
- (2) Compliance with (1) may be relied on as tending to establish compliance with 3-80(6).
- (3) Contravention of (1) may be relied on as tending to establish contravention of 3-80(6).

Group hedging arrangements

- 3-80(7) R** **A firm may amend its PRR to take account of a group hedging arrangement to which the firm is party, provided the group hedging arrangement is recorded by an agreement in writing between all the relevant parties and the firm first notifies the FSA in writing of the terms of the arrangement and of the proposed amendment to the PRR.**

Alternative treatments

- 3-80(8) R** **Where a firm has the alternative of treating a position under two or more different methods or treatments within methods, it must treat the position under one of those methods.**

Simpler approach to PRR calculation

- 3-80(9) R As a simpler approach to calculating PRR, a firm may calculate the total PRR by multiplying all positions in marketable investments by the relevant percentage stated in the table below and summing the results.**

TABLE 3-80(9)

Position risk requirement - simpler approach

C: Stock positions in *physical commodities*

Stock positions in <i>physical commodities</i> associated with a firm's investment business	30% of realisable value
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D: Certain *derivatives* and foreign exchange

<i>Exchange traded futures</i> and written <i>options</i>	4 x initial margin requirement
<i>OTC futures</i> and written <i>options</i>	Apply the percentage shown in C above to the <i>mark to market</i> value of the underlying position
Purchased <i>options</i>	Apply the percentage shown in C above to the <i>mark to market</i> value of the underlying position but the result may be limited to the <i>mark to market</i> value of the <i>option</i>
<i>Contracts for differences</i>	20% of the <i>mark to market</i> value of the contract
Foreign exchange exposure	10% of the net open long position

F: Other investments

Single premium unit linked bonds and units in a <i>regulated collective investment scheme</i>	50% of realisable value
Any other <i>investments</i>	100% of <i>mark to market</i> value of <i>investment</i> or underlying instrument
Notes	
	Percentage
1	A percentage means, unless otherwise indicated, a percentage of the <i>mark to market</i> value of the aggregate of the long and the short positions in the particular category.

	Netting	
2	The long or (short position) in a particular instrument is the net of any long or short positions held in that same instrument (i.e. a long position in ICI shares can be offset on a <i>share for share</i> basis against a short position in ICI shares) but positions in similar instruments (e.g. ICI shares against BP shares) cannot be offset in this way.	
	Stock positions in physical commodities	
3	A stock position in <i>physical commodities</i> is the <i>mark to market</i> value of the sum of -	
	(i)	commodities where the full contract price has been paid;
	(ii)	work in progress and finished goods which result from the processing of commodities; and
	(iii)	raw materials which will be combined with commodities to produce a finished processed commodity.
4	A stock position in <i>physical commodities</i> is regarded as being associated with a <i>firm's investment business</i> if the contract associated with the <i>physical commodity</i> was made for <i>investment</i> rather than commercial purposes. Indications of this are -	
	(i)	the contract is <i>exchange traded</i> or
	(ii)	the performance of the contract is guaranteed by an <i>exchange</i> an <i>approved exchange</i> or a <i>clearing house</i> .

Models approach to PRR calculation

- 3-80(10) G A *firm* that wishes to use its internal model to calculate *PRR* in respect of all, or some, of its positions will need to apply for a modification or waiver of the relevant *FSA* rules.
- G Further guidance on the criteria which such models must meet, and the review process, can be obtained from the *FSA*.

FOREIGN CURRENCY EXPOSURES AND FOREIGN CURRENCY DERIVATIVES METHODS

Summary of foreign currency exposures and derivatives methods

3-150 R A firm must calculate an additional PRR under the foreign currency exposures or foreign currency derivatives method where it has any asset or liability or any off-balance sheet contract which is denominated in a currency other than the currency of its books of account. For these purposes, gold must be treated as another currency.

3-151 Types of exposures to be treated as foreign currency exposures

General rule

3-151(1) R A firm must apply the foreign currency exposures or foreign currency derivatives method to the following positions, identifying each currency separately including the currency of its books of account:

- (a) any currency future at the nominal value of the contract;**
- (b) any currency option;**
- (c) any forward contract for the purchase or sale at the contract value, including any future exchange of principal associated with cross-currency swaps, but excluding any purchase or sale of known but unaccrued future income or expense;**
- (d) any other balance sheet asset or liability; and**
- (e) any other off balance sheet commitment to purchase or sell an asset denominated in that currency.**

Dual currency bonds

3-151(2) R In respect of a dual currency bond, a firm must include within the foreign currency exposures method a notional forward contract:

- (a) for the purchase of the redemption currency derived from the dual currency bond, for an amount determined by reference to the terms of issue of the dual currency bond; or**
- (b) for the sale of the issue currency, for an amount equal to the mark to market value of the dual currency bond, with a deemed settlement date equal to the maturity of the bond.**

Determining the currency of investments

3-151(3) R For the purposes of determining the currency in which a position in an investment is denominated, a firm must apply the following principles:

- (a) where the price of an instrument is quoted in only one currency, a position in that instrument must be treated as an asset or liability in that currency;
- (b) where the price of an instrument is quoted in more than one currency, a position in that instrument must be treated as an asset or liability in the currency in which the *firm* accounts for the instrument; and
- (c) notwithstanding (a) and (b) above, a position in an American depository receipt or similar form of instrument must be treated as a position, translated at current spot rate, in the currency of the underlying instrument.

3-152 Application of *foreign currency exposures* and *derivatives* methods to foreign currency *derivatives*

Risk assessment models

3-152(1) G A *firm* may seek a modification or waiver from the FSA to use a risk assessment model in respect of its currency *options* to calculate notional positions which may be included in the *foreign currency exposures method*, provided the model forms part of the day to day management supervision of the *firm's options* business and meets other criteria (further guidance on the criteria for the approval of such models can be obtained from the FSA).

Obligatory use of foreign currency derivatives method

3-152(2) R A *firm* must apply the *foreign currency derivatives method* to any currency *option* which is less than 5% “in the money”.

Optional use of foreign currency derivatives method

3-152(3) R Subject to (2) above, a *firm* may apply the *foreign currency derivatives method* to any *exchange traded currency option* or *future* instead of applying the *foreign currency exposures method*.

Obligatory use of foreign currency exposures method

3-152(4) R A *firm* must apply the *foreign currency exposures method* to any *OTC currency future*.

Calculation of “in the money”

3-152(5) R For the purposes of this rule, a *firm* must determine the extent to which the *option* contract is “in the money” by reference to the difference between the exercise price and the current forward rate for the final date on which the *option* may be exercised as a percentage of that forward rate.

3-153 Foreign currency derivatives method

Exchange traded futures and options

- 3-153(1) R** (a) **A firm must calculate the *PRR* of an *exchange traded* foreign currency *future* or *option* as 100% of the *initial margin requirement* of the *exchange* or *approved exchange* or, where the *initial margin requirement* is zero, under (2) below.**
- (b) **Where the *exchange* or *approved exchange* calculates the margin requirement on an overall basis, the *PRR* must equal that margin requirement.**
- (c) **Where the *exchange* offsets *futures* and *options* in the margin calculations, the *firm* may take into account such offsetting.**

OTC foreign currency options

- 3-153(2) R** **A firm must calculate the *PRR* of an *OTC* foreign currency *option* as 5% of the nominal value of the contract, adjusted as follows:**
- (a) **long position: the *PRR* may be restricted to the *mark to market* value of the *option*; and**
- (b) **short position: the *PRR* may be reduced (but to no less than zero) by any excess of the exercise value over the *mark to market* value for a *call option* or vice versa for a *put option*.**

3-154 Foreign currency exposure method

Application

- 3-154(1) R** **A firm must apply the *foreign currency exposure method* to any foreign currency exposure for which the *firm* has not calculated a *PRR* under the *foreign currency derivatives method*.**

Calculation of PRR

- 3-154(2) R** **A firm must calculate a *PRR* for its *foreign currency exposures* as 5% of the aggregate of its net open long positions in each currency, including the currency of the *firm's* books of account when this is a long open position.**

Calculation of net open position

- 3-154(3) R** (a) **A firm must calculate a net open position for all currencies including the currency of the *firm's* books of account by netting all *foreign currency exposures* to which the method applies.**

- (b) The net open position for the currency of the *firm's* books of account may be calculated as the difference between the aggregate net open long positions and aggregate net open short positions of all other currencies.

COMMODITIES METHOD

Types of positions to be included in the commodities method

3-166

General rule

- 3-166(1) R** **A *firm* must calculate *PRR* on all positions in commodities in accordance with one of the four approaches set out in rules 3-167 to 3-169A. All spot, physical trading, *derivative* and other off balance sheet items whose price is affected by changes in commodities prices must be included in the calculation.**

G In general, a commodity is a physical product which is or can be traded on the secondary market. Commodities include precious metals (except gold, which is to be treated as a foreign currency), agricultural products, minerals and base metals, oil and other energy products.

- 3-166(2) R** **A *firm* must calculate the *PRR* for each commodity separately, except that:**

- (a) **different sub-categories of the same commodity that are deliverable against each other may be treated together; and**
- (b) **commodities which are close substitutes for each other, and whose price movements over a minimum period of one year can be shown by the *firm* to exhibit a stable and reliable correlation of at least 0.9, may be treated together.**

G The onus is on the *firm* to show that the correlation referred to in (b) above exists on a continuing basis.

- 3-166(3) R** (a) **Positions which are purely stock financing may be omitted from the calculation of *PRR* on commodities positions under rule 3-166 and a *firm* may net notional long and short government *securities* arising from *swaps*, *FRAs*, *futures* and *options* on interest rates and debt *securities*, cash borrowings, *qualifying deposits*, the cash legs of “repurchase or similar agreements”, forward foreign exchange and foreign currency futures against each other, provided:**
- (i) **they are in the same currency;**
- (ii) **the interest rates are within 15 basis points;**

- (iii) (aa) if the maturity dates are less than one month, the dates are the same;
- (bb) if the maturity dates are between one month and one year, the dates are within seven days of each other; or
- (cc) if the maturity dates are over one year, the dates are within 30 days of each other;
- (iv) for a cash borrowing, the next interest rate refix date is within two years and repayment is within two years; and
- (v) for a *qualifying deposit*, the next interest rate refix date is within three months.

- (b) In respect of a cash borrowing or *qualifying deposit*, the maturity date is the earlier of the *repayment date* and the next interest rate refix date.
- (c) “Repurchase or similar agreement” means a *repurchase, reverse repurchase, securities or physical commodities lending, securities or physical commodities borrowing, sale and buy back, buy and sale back, undocumented sale and buy back, or undocumented buy and sale back agreement*.

G Stock financing is defined under the *Capital Adequacy Directive*. Where physical stock has been sold forward, the cost of funding must be locked in until the date of the forward *sale*.

3-167 Simplified approach

- 3-167(1)** R All positions in commodities or commodity *derivatives* must be expressed in terms of the standard unit of measurement for that commodity (such as tonnes, barrels or kilos).
- 3-167(2)** R A *firm* must multiply the position in each commodity by the current spot price for the commodity converted to the *firm's* reporting currency at current spot rates, and calculate the *PRR* as the sum of:
 - (a) the overall net position multiplied by 15%; and
 - (b) the gross position multiplied by 3%.
- 3-167(3)** R A *firm* must sum the results for each commodity to arrive at the total *PRR* for positions treated under the simplified approach.

3-168 Maturity ladder approach

3-168(1) R All positions in each commodity or commodity *derivatives* must be expressed in terms of the standard unit of measurement for that commodity (such as tonnes, barrels or kilos) or in terms of value. A *firm* must allocate net positions on any given day to the appropriate maturity band in the table below. Physical stock must be assigned to the first band.

Table 3-168

Maturity Bands for Maturity Ladder Approach	
0-1 month	1-2 years
1-3 months	2-3 years
3-6 months	over 3 years
6-12 months	

3-168(2) R A *firm* may then offset long and short positions within and between maturity bands in accordance with the following:

- (a) For markets which have daily delivery dates, a *firm* may offset contracts in the same commodity against each other provided that the expiry dates are within 10 *business days* of each other.
- (b) For each maturity band, the *firm* must sum all the open long positions, and sum all the open short positions. The *firm* may then subtract the shorts from the longs to form the overall net position. The amount subtracted is the “matched amount”. The *firm* must multiply twice the matched amount by the spread rate of 1.5%, and then by the spot price for the commodity to arrive at the spread risk charge.

G If the total of all longs in a maturity band is 100, and the total of all shorts is 75, the “matched amount” is 75 and the overall net position 25. Algebraically, if the total of all longs is A, and the total of all shorts is -B, the “matched amount” is $\min\{A,B\}$, and the overall net position is A-B.

- (c) The *firm* may then carry backwards or forwards all or part of the overall net position within a band to an adjacent maturity band for further netting allowances. Where this is the case, the *firm* must calculate:

- (i) a carry charge by multiplying the amount carried by the carry rate of 0.6%, and
- (ii) a spread charge, in accordance with (b) above, where the carried position is matched against a position in an adjacent maturity band.

The *firm* may repeat the procedure for carrying positions through to other maturity bands as appropriate. An additional carry charge and spread charge must be calculated at each stage of the process.

- (d) The *firm* must multiply any positions remaining after the permitted offsetting by the outright rate of 15%, and then by the spot price of the commodity to arrive at the outright charge.
- (e) The total *PRR* for each commodity is the sum of the spread risk charge, the carry charge, and the outright charge converted to the *firm's* reporting currency at current spot rates.

Extended maturity ladder approach

- 3-169 R** A *firm* may adopt the same approach as that outlined under rule 3-168(2), but apply the rates in the table below, if the *firm*:
- (a) undertakes significant commodities business, and
 - (b) has a diversified commodities portfolio.

Table 3-169

	Precious metals	Base metals	Soft commodities	Other commodities
Spread rate %	1.0	1.2	1.5	1.5
Carry rate %	0.3	0.5	0.6	0.6
Outright rate %	8.0	10.0	12.0	15.0

Models approach

- 3-169A G** A *firm* may seek a modification or waiver from the *FSA* to use a VaR model as the basis for calculating the *PRR* on its commodity positions.
- G** The *FSA* will grant a modification or waiver permitting the use of a VaR model only where a number of qualitative and quantitative standards are met. In assessing the VaR model the *FSA* will have regard to the matters set out in *BIPRU* 7.10.

3-169B Options

Proprietary options pricing models

3-169B (1) G A *firm* may seek a modification or waiver from the *FSA* permitting it to use its proprietary *options* pricing model to calculate the *PRR* on *options* positions and their related hedges. The application for a modification or waiver may request that the *firm* be permitted to include an *option* in the maturity ladder approach.

G A *firm* may propose any methodology that it believes will capture spread, carry and outright risks and that reflects its own day-to-day risk management. A *firm* is strongly advised to contact the *FSA* at the earliest point if it is considering introducing a model or adapting an existing one.

No models

3-169B (2) R A *firm* may only include an *option* in the maturity ladder approach, the extended maturity ladder approach or the simplified approach if it is in the money by more than the appropriate outright rate. Such *options* must be included as a position in the underlying commodity, of an amount equal to the “tonnage” underlying the *option* (long or short as appropriate), and with a maturity equal to the expiry date of the spot, forward or futures contract underlying the *option*.

3-169B (3) R An *option* which does not satisfy the condition in rule 3-169B(2) attracts a *PRR* in accordance with the following:

(a) In the case of a purchased *option*, the *PRR* must be the *mark to market* value of the full position underlying the *option* multiplied by the appropriate outright rate, but the result may be limited to the *mark to market* value of the *option*.

(b) In the case of a written *option*, the *PRR* must be the *mark to market* value of the full position underlying the *option* multiplied by the appropriate outright rate, reduced by the out-of-the-money amount. The *PRR* must be limited to zero if the calculation results in a negative number.

G The out-of-the-money amount is any excess of the exercise value over the *mark to market* value of the underlying commodity in the case of a *call option*, or vice versa for a *put option*.

COUNTERPARTY RISK REQUIREMENT

3-170 GENERAL PRINCIPLES OF CRR

Application

- 3-170(1) R (a) Rules 3-170 to 3-182 apply to a *broad scope firm*, except a *venture capital firm* which is subject only to rules 3-180 to 3-182.
- (b) Rules 3-180 to 3-182 apply to an *arranger*, except a *corporate finance advisory firm*.

General rule

- 3-170(2) R A *firm* must calculate its total *CRR* on exposures to *counterparties* as the sum of all the amounts calculated in accordance with the rules referred to in the table below.

- R Table 3-170(2) - Counterparty Risk Requirement

Rules

3-171	Cash against documents transactions
3-173	Free deliveries of physical securities and commodities
3-173A	Derivatives transactions
3-175	Concentrated risk to one counterparty
3-176	Repurchase and reverse repurchase, securities lending and borrowing and sale and buy back agreements
3-177	Money brokers
3-178	Options purchased for a counterparty
3-180	Qualifying and other deposits
3-181	Loans to counterparties
3-182	Other amounts owed to a firm arising out of investment business or investment dealing activities

Frequency of calculation

- 3-170(3) R A *firm* must calculate its *CRR* at least once each *business day*; for the purposes of the relevant calculations the *firm* may use prices of *investments* and *physical commodities* as at the close of business on the previous day.

Negative amounts

3-170(4) R A firm must not include any CRR if it is a negative amount.

Instruments for which no CRR has been specified

3-170(5) R Where a firm is in doubt as to the classification of an item for the purposes of CRR, the firm must add to its CRR an appropriate part of the exposure on the item concerned and must immediately notify the FSA in writing of details of the transaction, the counterparty and the proposed CRR treatment.

3-170(5A) E (1) In 3-170(5) “an appropriate part” is:

(a) the whole; or

(b) A proportion which takes account of the characteristics of the transaction and the counterparty concerned, and of discussions with the FSA or a predecessor regulator.

(2) Compliance with (1) may be relied on as tending to establish compliance with 3-170(5).

(3) Contravention of (1) may be relied on as tending to establish contravention of 3-170(5).

Provisions

3-170(6) R A firm may reduce the exposure on which its CRR is calculated to the extent that it makes provision for a specific counterparty balance.

Connected companies

3-170(7) R For the avoidance of doubt, a firm must calculate a CRR as appropriate on exposures to or from connected companies.

Basis of valuation

3-170(8) R For the purposes of valuing instruments and physical commodities at market value in the calculation of CRR, a firm must be consistent in the basis it chooses and may use either mid market value or bid and offer prices (as appropriate).

Acceptable collateral

- 3-170(9) R A firm may reduce the exposure to a counterparty on which its CRR is calculated to the extent that it holds acceptable collateral from that counterparty.**

Nil weighted counterparty exposures

- 3-170 (10) R A firm may disregard any counterparty exposure calculated in accordance with rules 3-171 to 3-182, if the counterparty is or the contract is guaranteed by or is subject to the full faith and credit of a sovereign government or province or state thereof (or a corporation over 75% owned by such government, province or state), which is a member of the OECD and the government, province, state or corporation has not defaulted, or entered into any rescheduling or similar arrangement, or announced the intention of so doing, in respect of itself or its agency's debt within the last five years.**

Netting

- 3-170 (11) R A firm which has offsetting exposures in similar types of transactions with a counterparty may offset these in accordance with rules 3-171(2A), 3-173(2A), 3-173A(3), 3-176(3), 3-180(2A), 3-181(1) and 3-182(4A) when calculating CRR if it has a contractual netting agreement with that counterparty, which:**

- (a) covers the transactions which the firm is seeking to net;**
- (b) creates a single obligation in each currency or a single overall obligation to pay (or receive) a net sum of cash in the event of default, bankruptcy, liquidation or similar circumstances;**
- (c) does not include a walkaway clause;**
- (d) is supported by written and reasoned independent legal opinions to the effect that, in the event of a legal challenge, the relevant courts would find the firm's exposure to be the single net amount mentioned in (b) above.**

G Legal opinions should relate to:

- (a) the law of the jurisdiction in which the counterparty is organised;
- (b) the law of the jurisdiction in which any branch involved is located;
- (c) the law that governs the agreement and, if different, the law that governs individual transactions pursuant to it; and
- (d) the law that governs the legal status of the counterparty who is entering into transactions of the type which the firm is seeking to net.

- G Where a *firm* uses an industry standard agreement and the *firm's* netting/set-off clauses follow the form of that standard agreement, provided a legal opinion has already been obtained on the standard agreement which addresses the capacity of *counterparties* of the type with which the *firm* wishes to contract, that may be relied upon.
- G Legal opinions on netting agreements should be obtained from independent legal advisers with sufficient expertise and experience in this area of law. Opinions from in-house counsel will not be acceptable. Where the regulator of the *counterparty* is not satisfied that the netting agreement is enforceable under its laws, the netting agreement cannot be relied upon regardless of the opinions obtained by the *firm*.

3-171 Cash against documents transactions

General rule

- 3-171(1) R A *firm* which enters into a transaction on a cash against documents basis must calculate the *counterparty* exposure for transactions still unsettled 16 calendar days after *settlement day* as set out in (2) below and must then multiply this by the appropriate percentage set out in the table below to calculate a *CRR* for each separate unsettled transaction.**

- R **Table 3-171(1) - Percentage to be applied to the counterparty exposure**

Calendar days after settlement day	Percentage
0 – 15	Nil
16 – 30	25%
31 – 45	50%
46 – 60	75%
Over 60	100%

Counterparty exposure calculation

- 3-171(2) R (a) Where a *firm* has neither delivered *securities* or *physical commodities* nor received payment when purchasing *securities* or *physical commodities* for, or selling *securities* or *physical commodities* to, a *counterparty*, the positive *counterparty* exposure is the excess of the contract value over the market value of the *securities* or *physical commodities*.**
- (b) Where a *firm* has neither received *securities* or *physical commodities* nor made payment when selling *securities* or *physical commodities* for, or purchasing *securities* or *physical commodities* from, a *counterparty*, the positive *counterparty* exposure is the excess of the market value over the contract value of the *securities* or *physical commodities*.**

Netting

- 3-171 (2A)** R **A *firm* may offset positive and negative *counterparty* exposures, calculated in accordance with (2) above, before it multiplies the residual exposure by the appropriate percentage in Table 3-171(1) provided that:**
- (a) the exposures arise on transactions with the same *counterparty*; and**
 - (b) the *firm* has a written agreement supported by a legal opinion obtained in accordance with rule 3-170(11).**

Sub-total

- 3-171(3)** R **The sum of the amounts calculated in accordance with (1) above is the *firm's* total *CRR* for cash against documents transactions.**

3-173 Free deliveries of physical commodities and securities

General rule

- 3-173(1)** R **When a *firm* makes delivery to a *counterparty* of *physical commodities* or *securities* without receiving payment or pays for *securities* without receiving the certificates of good title, the *firm* must calculate the *free delivery* value for each transaction.**

Free delivery value calculation

- 3-173(2)** R **A *firm* must calculate the *free delivery* value for each transaction as set out below and multiply this value by the appropriate percentage in Table 3-173(2) A for free deliveries of *physical commodities* and Table 3-173 (2) B for free deliveries of *securities* as follows:**
- (a) if the *firm* has delivered *physical commodities* or *securities* to a *counterparty* and has not received payment, the *free delivery* amount is the full amount due to the *firm* (i.e. the contract value);**
 - (b) if the *firm* has made payment to a *counterparty* for *securities* and not received the certificates of good title, the *free delivery* amount is the market value of the *securities*; and**
 - (c) if a *firm* pays for *physical commodities* without receiving delivery or *documents of title* the exposure is to be treated as an unsecured loan to which rule 3-181 applies.**

R Table 3-173(2)A - Percentage to be applied to free deliveries relating to physical commodities

	Nature of counterparty to whom free delivery is made	Business days since delivery		
		0 - 3	4 - 15	earlier of 15 days or agreed contractual payment date
1	<i>Firm does not have an ACMP and delivery of physical commodities is made</i>	15%	100% of contract value	100% of contract value
2	<i>Firm has an ACMP and delivery of physical commodities is made with a settlement day longer than three days from delivery date</i>	15% of contract value		100% of contract value

R Table 3-173(2)B - Percentage to be applied to free deliveries relating to securities

	Nature of counterparty to whom free delivery is made	Business days since delivery		
		0 - 3	4 – 15	over 15
1	A <i>counterparty</i> to whom <i>securities</i> have been delivered or to whom payment for <i>securities</i> has been made	nil	100% of contract or market value	100% of contract or market value
2	A <i>regulated financial institution</i> or <i>regulated banking institution</i> to whom <i>securities</i> have been delivered or payment made with the expectation that market practice will result in a <i>settlement day</i> longer than three days from delivery date	15% of contract or market value		100% of contract or market value
2A	A <i>counterparty</i> to whom <i>securities</i> have been delivered which settle through the Crest system or to whom payment for such <i>securities</i> has been made	15% of contract or market value		100% of contract or market value
3	A manager, underwriter, sub-underwriter or member of a selling syndicate or issuer to whom payment for <i>securities</i> has been made; or a manager of a <i>regulated collective investment scheme</i> to whom units of the scheme have been delivered or payment for units of the scheme has been made	nil		100% of contract or market value or, if the issue is in one of the countries specified in Appendix 46, 15% of contract or market value until the end of the period referred to in that Appendix

Netting

**3-173
(2A)**

R A firm may reduce the *free delivery* value for a transaction calculated in accordance with (2) above, before it multiplies the residual exposure by the appropriate percentage in Table 3-173(2)A or B, by:

- (a) the value of any free payment received from the *counterparty*; or**
- (b) the contract value of any *securities* received free from the *counterparty*,**

provided that:

- (i) the exposures arise on transactions with the same *counterparty*; and
- (ii) the *firm* has a written agreement supported by a legal opinion obtained in accordance with rule 3-170(11).

Partners and connected persons

- 3-173(3) R** For the purpose of this rule, a *firm* must treat any amount due from a partner or his *connected person* in respect of *investment business* as a *free delivery to a counterparty*.

Sub-total

- 3-173(4) R** The sum of the amounts calculated in accordance with (1), (2) and (3) above is the *firm's* total *CRR* for free deliveries of *physical commodities* and *securities*.

3-173A Derivative transactions

General rule

- 3-173A (1) R** A *firm* must calculate for each *derivative* transaction a *CRR* either:
- (a) by multiplying the *counterparty* exposure calculated in accordance with (2) and (3) below by the appropriate percentage in Table 3-173A(4)A or B, except for single premium *options* purchased on behalf of a *counterparty* and *traditional options* purchased for the *firm's* own account or on behalf of a *counterparty*, which shall be subject to rule 3-178; or
 - (b) after notifying the *FSA* in writing, in accordance with rule 10-174.

Counterparty exposure

- 3-173A (2) R** A *firm* must calculate the *counterparty* exposure on *derivative* transactions in accordance with either (a) or (b) below:
- (a) where a *counterparty* has not fully paid an *initial margin requirement* or *variation margin requirement* on a transaction in a *derivative* listed on an *exchange* or *approved exchange* or met it through the deposit of *acceptable collateral* not otherwise used, the *firm* must calculate the *counterparty* exposure as the shortfall;
 - (b) where the *counterparty* exposure arising from a transaction in a *derivative* is not listed on an *exchange* or *approved exchange*, the *counterparty* exposure is the credit equivalent amount calculated in accordance with Table 3-173A(2A).

R Table 3-173A(2A) – Method of calculating credit equivalent amount

Type of derivative transaction	Credit equivalent amount	
	If A is positive	If A is negative
Interest rate swaps: single currency		
(a) floating rate swapped against floating rate	A	nil
(b) fixed rate swapped against floating rate:		
- under one year to maturity	A	nil
- over one year to five years	A + 0.5% of N	0.5% of N
- over five years	A + 1.5% of N	1.5% of N
Cross-currency interest rate swaps		
- under one year to maturity	A + 1% of N	1% of N
- over one year to five years	A + 5% of N	5% of N
- over five years	A + 7.5% of N	7.5% of N
Other interest rate contracts*		
- under one year to maturity	A	nil
- over one year to five years	A + 0.5% of N	0.5% of N
- over five years	A + 1.5% of N	1.5% of N
Foreign exchange and gold contracts*		
- exchange rate contracts with an original maturity of 14 days or less	nil	nil
- under one year to maturity	A + 1% of N	1% of N
- over one year to five years	A + 5% of N	5% of N
- over five years	A + 7.5% of N	7.5% of N
Equity contracts*		
- under one year to maturity	A + 6% of N	6% of N
- over one year to five years	A + 8% of N	8% of N
- over five years	A + 10% of N	10% of N
Precious metal (not gold) contracts*		
- under one year to maturity	A + 7% of N	7% of N
- over one year to five years	A + 7% of N	7% of N
- over five years	A + 8% of N	8% of N
Commodity contracts*		
- under one year to maturity	A + 10% of N	10% of N
- over one year to five years	A + 12% of N	12% of N
- over five years	A + 15% of N	15% of N
Notes		
<i>FRAs, swaps, futures, purchased options, and other contracts for differences</i>		
A = the replacement cost of the contract		
N = the notional or actual principal amount underlying the contract		

For contracts with multiple exchanges of principal, the % of N has to be multiplied by the remaining number of payments still to be made according to the contract.

In the case of a derivative referenced on a bond which satisfies the criteria for a *qualifying debt security*, the %N applicable to interest rate derivatives may be utilised to calculate the credit equivalent amount. For a derivative referenced on a 'non-qualifying' bond, the credit equivalent amount must be calculated with reference to the %N applicable to equity derivatives.

For contracts that are structured to settle outstanding exposure following specified payment dates and where the terms are reset such that the market value of the contract is zero on these specified dates, the residual maturity would be equal to the time until the next reset date. In the case of interest-rate contracts that meet these criteria and have a remaining maturity of over one year, the percentage is no lower than 0.5%.

R If a firm uses the extended maturity ladder approach to calculate PRR under rule 3-169, it may use Table 3-173A(2B).

R Table 3-173A(2B) – Method of calculating credit equivalent amount for commodities

Type of derivative transaction*	Credit equivalent amount	
	If A is positive	If A is negative
Precious metals (except gold) <ul style="list-style-type: none"> - under one year to maturity - over one year to five years - over five years 	A + 2% of N A + 5% of N A + 7.5% of N	2% of N 5% of N 7.5% of N
Base metals <ul style="list-style-type: none"> - under one year to maturity - over one year to five years - over five years 	A + 2.5% of N A + 4% of N A + 8% of N	2.5% of N 4% of N 8% of N
Softs (agricultural) <ul style="list-style-type: none"> - under one year to maturity - over one year to five years - over five years 	A + 3% of N A + 5% of N A + 9% of N	3% of N 5% of N 9% of N
Other commodity <ul style="list-style-type: none"> - under one year to maturity - over one year to five years - over five years 	A + 4% of N A + 6% of N A + 10% of N	4% of N 6% of N 10% of N
Notes <i>FRAs, swaps, futures, purchased options, and other contracts for differences</i> A = the replacement cost of the contract N = the notional or actual principal amount underlying the contract For contracts with multiple exchanges of principal, the % of N has to be multiplied by the remaining number of payments still to be made according to the contract.		

In the case of a derivative referenced on a bond which satisfies the criteria for a *qualifying debt security*, the %N applicable to interest rate derivatives may be utilised to calculate the credit equivalent amount. For a derivative referenced on a 'non-qualifying' bond, the credit equivalent amount must be calculated with reference to the %N applicable to equity derivatives.

For contracts that are structured to settle outstanding exposure following specified payment dates and where the terms are reset such that the market value of the contract is zero on these specified dates, the residual maturity would be equal to the time until the next reset date. In the case of interest-rate contracts that meet these criteria and have a remaining maturity of over one year, the percentage is no lower than 0.5%.

Netting

- 3-173A (3)** **R** **A firm may offset counterparty exposures arising on derivative transactions calculated in accordance with (2) above before it multiplies the residual exposure by the appropriate CRR percentage as follows:**
- (a) variation margin payable to a counterparty against an initial margin requirement or variation margin requirement receivable from a counterparty;**
 - (b) variation margin payable to a counterparty against a positive “A” as calculated in accordance with Table 3-173A(2A);**
 - (c) a negative “A” as calculated in accordance with Table 3-173A(2A) against an initial margin requirement or variation margin requirement receivable from a counterparty;**
 - (d) a negative “A” against a positive “A” in each case as calculated in accordance with Table 3-173A(2A);**
 - (e) losses on a closed out derivative transaction which has not been settled against variation margin payable to a counterparty; or**
 - (f) losses on a closed out derivative transaction which has not been settled against negative “A” calculated in accordance with Table 3-173A(2A),**
 - (g) profit on a closed out derivative transaction which has not been settled against an initial margin requirement or variation margin requirement receivable from a counterparty;**
 - (h) profit on a closed out derivative transaction which has not been settled against a loss on a closed out derivative transaction;**
 - (i) profit on a closed out derivative transaction which has not been settled against a positive “A” as calculated in accordance with Table 3-173A(2A);**
 - (j) premium receivable in respect of written options against variation margin payable, initial margin payable or a closed out profit payable to the counterparty or a negative “A” as calculated in accordance with Table 3-173A(2A);**
 - (k) positive “A” on purchased options calculated in accordance with Table 3-173A(2A) against negative “A” on written options; or**
 - (l) in the case of perfectly matched contracts these may be treated as a single contract with a notional principal equivalent to the net receipts; or**

(m) where transactions are subject to (3)(c) above, the potential future credit exposures (PFCE) on transactions with the same *counterparty* (i.e. % on N) may be netted in accordance with Table 3-173A(3) below,

provided that:

- (i) the exposures arise on transactions with the same *counterparty*; and
- (ii) the *firm* has a written agreement, supported by a legal opinion obtained in accordance with rule 3-170(11).

Table 3-173A(3)

The netted PFCE is the sum of:	
step one	40% of gross PFCE
step two	60% of gross PFCE multiplied by the net-to-gross ratio (NGR)
<p>Notes:</p> <p>NGR = $\frac{\text{(net replacement cost)}}{\text{(gross replacement cost)}}$</p> <p>The NGR must be calculated on all contracts included in a legally valid bilateral netting agreement with a given <i>counterparty</i>.</p>	

CRR percentages

- 3-173A (4)** **R (a)** **Where a *firm* does not offset *counterparty* exposures arising on *derivative* transactions in accordance with (3) above, it must multiply the *counterparty* exposure by the appropriate percentage from:**
- (i)** **Table 3-173A(4)A if the *counterparty* exposure arises on a transaction in a *derivative* listed on an *exchange* or *approved exchange*; or**
 - (ii)** **Table 3-173A(4)B if the *counterparty* exposure arises on a transaction in a *derivative* not listed on an *exchange* or *approved exchange*,**
- but may opt to calculate *CRR* using the highest available credit percentage in Tables 3-173A(4)A or B below in order to avoid undue complication.**
- (b)** **Where a *firm* does offset *counterparty* exposures on *derivative* exposures in accordance with (3) above, it must multiply the residual net *counterparty* exposure by the appropriate percentage from Table 3-173A(4)A or B.**
- (c)** **A *firm* may opt to calculate the *CRR* using the highest available *CRR* percentage in the tables below in order to avoid undue complication.**

Table 3-173A(4)A - CRR percentages for transactions in derivatives listed on an exchange or approved exchange

Counterparty		Business days since exposure occurred	
		0 - 3	over 3
1	<i>Firm</i> has an <i>ACMP</i> and <i>counterparty</i> is not a <i>market counterparty</i>	10%	10%
2	<i>Firm</i> has an <i>ACMP</i> and <i>counterparty</i> is a <i>market counterparty</i>	5%	5%
3	<i>Firm</i> does not have an <i>ACMP</i>	10%	100%

Table 3-173A(4)B - CRR percentages for transactions in derivatives not listed on an exchange or approved exchange

	Status of the counterparty	%
1	<i>A firm, a supranational organisation, a United Kingdom discount house, a gilt edged market maker, a stock exchange money broker, a regulated banking institution, a building society under the Building Societies Act 1986, a United Kingdom local authority, a regulated financial institution.</i>	2%
2	<i>Any other counterparty</i>	5%

Exposures to locals

- 3-173A (5) R** **A firm must calculate a 100% CRR for amounts of initial and variation margin not met with acceptable collateral or a positive equity balance owed to a firm by a local in respect of transactions in derivatives listed on an exchange or approved exchange from the date of any shortfall. However, a firm may use an alternative treatment if it:**
- (a) **participates in the profits or losses of the local for 25% or more when the firm may include the local position in its own position which will then be subject to PRR; or**
 - (b) **calculates PRR for locals in which case its requirement will be the sum of the following:**
 - (i) **10% of the PRR result for each local; and**
 - (ii) **the excess over the “net liquidating balance” of the PRR applied to the positions of each local; and**
 - (c) **for the purposes of (b) above, “net liquidating balance” means the cash amount which would remain in a local account if all positions were liquidated and there were added (1) cash balances (2) the value of marketable investments, and (3) letters of credit and guarantees issued by a regulated banking institution which is not the counterparty or an associate of the counterparty in the control of the firm; and there were deducted all loans and overdrafts from, and other liabilities to the firm; and to the extent that a firm includes an exposure in the net liquidating balance calculation, it does not also need to apply the liquidity adjustment in rule 3-75 or the CRR to those exposures.**

Sums due for payment or owed on closed out derivative transactions

3-173A (6) R When a *counterparty* has not fully met amounts owed to a *firm* arising out of losses on closed out *derivative* transactions by depositing, *acceptable collateral* or, has not fully settled amounts owed in respect of periodic or final settlement of transactions, a *firm* must calculate a *CRR* equal to the amount outstanding after three days, unless:

(a) the *firm* has offset the amount owed against variation margin payable in accordance with (3)(e) above; or

(b) the *firm* has offset the amount owed against a negative “A” in accordance with (3)(f) above,

in which case the *firm* must calculate a *CRR* equal to the residual amount outstanding after three days.

Equivalent contracts

3-173A (7) R Rule 3-173A(2)(b) also applies to contracts which, although they are listed on an *exchange* or *approved exchange*, are fully dependent upon the issuer for performance (e.g. covered *warrants*).

Regulated connected companies

3-173A (8) R Where a *firm* carries out significant *swaps* business with a *connected company* which has adequate regulation applied to it, the *firm* need not comply with all or part of rule 3-173A so far as it applies to interest rate or foreign exchange *swaps* with that *connected company*, provided that it has given prior written notice of this to the *FSA*.

Sub-total

3-173A (9) R The sum of the amounts calculated in accordance with this rule is the *firm's* total *CRR* for *derivative* transactions other than those subject to rule 3-178.

3-175 Concentrated risk to one counterparty

General rule

3-175(1) R When the total amount due to a *firm* arising from *exchange traded* variation margins or free deliveries of *physical commodities* from a single *counterparty* (or several *counterparties* grouped together by the *firm* for margin or credit treatment) is outstanding under a credit line granted in accordance with an *ACMP* and exceeds 25% of the *firm's* *financial resources*, the *firm* must calculate an additional *CRR* according to the table below.

Table 3-175(1) - Concentrated risk percentages

% of financial resources exposed to counterparty	Standard CRR for variation margin	Standard CRR for free delivery	Additional CRR
0 - 25%	10%	15%	nil
25% - 50%	10%	15%	lower of (1) the excess or (2) the sum of 15% for variation margin plus 10% for free deliveries
over 50%	10%	15%	lower of (1) the excess or (2) the sum of 40% for variation margin plus 35% for free deliveries

Use of approved bank bonds

- 3-175(2) R** If an *approved bank bond* forms a part of a *firm's financial resources*, a *firm* may include it in *financial resources* for the purposes of (1) above at its face value.

Sub-total

- 3-175(3) R** The sum of the amounts calculated in accordance with (1) above is the total *CRR* for concentrated risk to one *counterparty*.

- 3-176 R** All *repurchase, reverse repurchase, securities or physical commodities* (10) *lending or borrowing sale and buy back and buy and sale back agreements* with a stock exchange, *clearing house*, Clearstream or Euroclear are exempt from this rule.

Repurchase, securities lending and sale and buy back agreements

- 3-176(1) R** Where a *firm* has entered into any *repurchase, securities or physical commodities lending or sale and buy back agreement* in respect of *securities or physical commodities*, it must calculate, subject to (3) below, a *CRR* for each such agreement in accordance with the table below.

Table 3-176(1) - Repurchase, securities lending and sale and buy back agreements

Type of security sold or lent	CRR
<i>Qualifying debt securities</i>	The “mark to market value” of the <i>securities</i> less 105% of the <i>acceptable collateral</i> under the agreement, if the net figure is positive.
<i>Other securities or physical commodities</i>	The “mark to market value” of the <i>securities</i> or <i>physical commodities</i> less 110% of the <i>acceptable collateral</i> under the agreement, if the net figure is positive.

Reverse repurchase, securities borrowing and buy and sale back agreements

3-176(2) R Where a *firm* has entered into any *reverse repurchase, securities or physical commodities borrowing or buy and sale back agreement* in respect of *securities or physical commodities*, it must calculate, subject to (3) below, a *CRR* for each such agreement in accordance with the table below.

R Table 3-176(2) - Reverse repurchase, securities borrowing and buy and sale back agreements

Type of security purchased or borrowed		CRR
1	For all transactions where the <i>firm</i> has in its possession a “written agreement” evidencing the transaction, in accordance with rule 3-176(5)	
	a) <i>qualifying debt securities</i>	The amount paid or collateral given for the <i>securities</i> less 105% of the current “mark to market value” of the <i>securities</i> received (see note), if the net figure is positive
	b) <i>other securities or physical commodities</i>	The amount paid or collateral given for the <i>securities</i> or <i>physical commodities</i> less 110% of the current “mark to market value” of the <i>securities</i> or <i>physical commodities</i> received (see note), if the net figure is positive
2	Where a <i>firm</i> does not have in its possession a “written agreement” evidencing the transaction, in accordance with rule 3-176(5)	The appropriate requirements from 1 plus the market value of the <i>securities</i> or <i>physical commodities</i> multiplied by the appropriate <i>PRA</i>

Note: the *securities* or *physical commodities* received can be included only where they are held under the control of the *firm* or where they were delivered into the control of the *firm* upon initiation of the agreement.

Netting

- 3-176(3) R** A *firm* may reduce the *CRR* by netting where it has more than one exposure to an individual *counterparty* provided that it has a written agreement supported by a legal opinion obtained in accordance with rule 3-170(11) as follows:
- (a) in the case of *sale and buy back, repurchase* or *securities or physical commodities lending agreements* (Table 3-176(1)), a *firm* may reduce the *CRR* by the excess of the total value of collateral received, including accrued interest, over the “mark to market” value of any other *sale and buy back, repurchase* or *securities or physical commodities lending agreements* with the same *counterparty*;
 - (b) in the case of *sale and buy back, reverse repurchase* or *securities or physical commodities borrowing agreements* (Table 3-176(2)), a *firm* may reduce the *CRR* by the excess of the “mark to market value” over the total value of collateral given, including accrued interest, of any other of *buy and sale back, reverse repurchase* or *securities or physical commodities borrowing agreements* with the same *counterparty*; and
 - (c) to the extent that an excess has not been used under (a) or (b) above to reduce the *CRR*, a *firm* may use an excess on a *sale and buy back, repurchase* or *securities or physical commodities lending agreement* respectively to reduce the *CRR* on a *buy and sale back, reverse repurchase* or *securities or physical commodities borrowing agreement* and vice versa provided the agreements are with the same *counterparty*.

Margin percentages

- 3-176(4) R** A *firm* may opt to calculate the *CRR* using the lower collateral rate (105%) in order to avoid undue complication.

“Written agreement”

- 3-176(5) R** For the purpose of this rule and rule 3-177(2), a “written agreement” must, whether in a general agreement or in respect of specific occasions, include the following elements:
- (a) the names of the persons involved;

- (b) the type and quantity of *securities* or *physical commodities* subject to the *reverse repurchase, securities or physical commodities* borrowing, or *buy and sale back agreement*;
- (c) the type and quantity of collateral;
- (d) the commencement date of the *reverse repurchase, securities or physical commodities* borrowing or *buy and sale back agreement*;
- (e) the completion date of the *reverse repurchase, securities or physical commodities* borrowing or *buy and sale back agreement*, where appropriate;
- (f) interest or fee arrangements, where appropriate;
- (g) arrangements for adjustments in the amount or type of *securities* or *physical commodities* to be returned, if appropriate;
- (h) arrangements for the calling of margin, if appropriate; and
- (i) agreements for completion,

except that having given prior written notice to the *FSA*, a *firm* may disregard certain of the “written agreement” requirements where it can show there are adequate *internal controls* to evidence the arrangements.

“Mark to market value”

- 3-176(6) R** For the purposes of this rule, the current “mark to market value” of *securities* and the value of cash lodged must include accrued interest.

Daily valuation

- 3-176(7) R** A *firm* must value collateral and *securities* or *physical commodities* lent or sold, or borrowed or purchased, at least daily.

Settlement failure and pre deliveries

- 3-176(8) R** Where:
- (a) simultaneous delivery of *securities* or *physical commodities* and collateral cannot be confirmed immediately due to settlement failure, or
 - (b) a *firm* has delivered collateral or *securities* or *physical commodities* prior to the receipt of *securities* or *physical commodities* or collateral,

the *firm* is not required to calculate a *CRR* for three *business days* from the date of payment or delivery by the *firm*.

Additional acceptable collateral

- 3-176(9) R** Where the *firm* has called for additional *acceptable collateral* from the other party to the agreement, a *firm* is not required to calculate a *CRR* if that call has been outstanding for no more than one *business day*.

Exclusions

- 3-176 (10) R** All *repurchase, reverse repurchase, securities or physical commodities lending or borrowing sale and buy back and buy and sale back agreements* with a stock exchange, *clearing house*, Clearstream or Euroclear are exempt from this rule.

Sub-total

- 3-176 (11) R** The sum of the amounts calculated in accordance with this rule is the total *CRR* for *repurchase and reverse repurchase, securities or physical commodities lending and borrowing and sale and buy back agreements*.

- 3-177** Money brokers

Application

- 3-177(1) R** This rule applies to *money brokers*.

Lending money

- 3-177(2) R** When a *money broker* is lending money it must calculate a 100% *CRR* except to the extent that it holds *acceptable collateral*; except where the broker does not have a “written agreement” in accordance with rule 3-176(5) between the *firm* and *counterparty* specifying, inter alia, the interest rate on the loan and stating that the loan is repayable on demand or for a term no longer than 30 days, when the *CRR* is 100% of the amount outstanding.

Lending and borrowing securities etc

- 3-177(3) R** For all *reverse repurchase and repurchase agreements, securities borrowing and lending agreements and buy and sale back and sale and buy back agreements* other than where *securities* are lent or sold or borrowed or purchased through an approved payments system, a *money broker* must calculate an additional *CRR* of 0.5% applied to the value of all *securities* transferred.

Sub-total

- 3-177(5) R** The sum of the amounts calculated in accordance with (2) and (3) above is the *firm's* total *CRR* for *money brokers*.

3-178 Options purchased for a counterparty

Single premium options

- 3-178(1) R** Where a *firm* has purchased a single premium *option* on behalf of a *counterparty* and the *counterparty* has not paid the full *option* premium cost by three *business days* after trade date, a *firm* must calculate a *CRR* as the amount by which the *option* premium owed to the *firm* exceeds the market value of the *option* or *acceptable collateral*.

Traditional options

- 3-178(2) R** Where a *firm* has purchased a *traditional option* for its own account or a *counterparty* and paid the *option* premium, it must calculate a *CRR* equal to the value of the *option* premium.

Sub-total

- 3-178(3) R** The sum of the amounts calculated in accordance with (1) and (2) above is the *firm's CRR* in respect of purchased *options*.

3-180 Qualifying and other deposits

General rule

- 3-180(1) R** Subject to (2) below, a *firm* must calculate a *CRR* for a deposit referred to in the table below by multiplying the value of the deposit by the appropriate percentage contained in the table below.

R Table 3-180(1) - Qualifying and other deposit risk percentages

Type of deposit	%
<i>Qualifying deposits</i>	nil
Other deposits with an <i>approved bank</i> related to a transaction creating an offsetting liability for the <i>firm</i> or subject to an agreement with the bank allowing its use as collateral for a loan that may be withdrawn within -	
- three months to one year	2.5%
- over one year	4.0%
Note:	all other deposits are subject to a liquidity adjustment (see rule 3-75(12))

Timing

- 3-180(2) R** *Qualifying deposits* and other deposits outstanding three days after a repayment request has been made or more than three days past maturity date are subject to a full *CRR*.

Netting

- 3-180 (2A) R** A *firm* may reduce the value of the deposit by an amount owed by the *firm* to a *counterparty* before it multiplies the residual exposure by the appropriate percentage in Table 3-180(1) provided that:
- (a) the exposures arise with the same *counterparty*; and
 - (b) the *firm* has a written agreement supported by a legal opinion obtained in accordance with rules 3-170(11).

Sub-total

- 3-180(3) R** The sum of the amounts calculated in accordance with Table 3-180(1) is the *firm's CRR* for *Qualifying deposits* and other deposits.

- 3-181** Loans to counterparties

General rule

- 3-181(1) R** A *firm* must calculate a 100% *CRR* on the amount by which a loan to a *counterparty* is not:
- (a) secured by *acceptable collateral*; or
 - (b) offset against amounts owed by the *firm* to the *counterparty* where the *firm* has a written agreement supported by a legal opinion obtained in accordance with rule 3-170(11).

Sub-total

- 3-181(2) R** The sum of the amounts calculated in accordance with this rule is the *firm's CRR* for loans to *counterparties*.

- 3-182** Other amounts owed to a firm arising out of investment business or investment dealing activities

Nil *CRR* items

- 3-182(1) R** The following receivables arising out of *investment business* or *investment dealing activities* do not require a *CRR* at any time:
- (a) any debt not covered elsewhere in the *CRR* rules to the extent that it is *adequately secured*;

- (b) amounts in respect of 30 day items specified in (3) below which have been outstanding for less than 30 days from the date on which they were first recorded on the *firm's* balance sheet; and
- (c) accrued income for interest on *marketable investments*, except where it has been outstanding for more than 30 days after the date that the interest was due to be received.

CRR on amounts owed to a firm in respect of international underwriting and stabilisation activities

- 3-182(2) R**
- (a) Where management or other fees are owed to a *firm* in respect of international underwriting or stabilisation activities, the *firm* must calculate full *CRR* on any amounts remaining unpaid 30 days after they first appeared on the *firm's* balance sheet.
 - (b) A *firm* acting as stabilising manager must also calculate a *CRR* equal to 100% of any income accrued as a result of net profit on stabilising activities while the stabilising account remains open.

CRR on 30 day items

- 3-182(3) R**
- A *firm* must calculate a 100% *CRR* in respect of the following receivables due to the *firm* if they have been outstanding for more than 30 days from the date on which they were first recorded on the *firm's* balance sheet:
- (a) commissions and fees earned in connection with the *firm's investment business*;
 - (b) commissions and fees earned which are due and payable from *client* bank accounts;
 - (c) repayments of *marketable investments* at maturity or call;
 - (d) the value of scrip issues and rights issues;
 - (e) proceeds arising from takeovers and mergers;
 - (f) domestic *underwriting* or stabilisation fees; and
 - (g) accrued income and work in progress.

100% CRR items

- 3-182(4) R**
- A *firm* must calculate a 100% *CRR* in respect of other receivables arising from *investment business* and *investment dealing activities* not covered elsewhere in this rule from the time that the receivable is recorded on the balance sheet.

Netting

- 3-182 (4A)** R **A *firm* may reduce the value of the amounts owed to the *firm* by an amount owed by the *firm* to a *counterparty* before it multiplies this by 100% provided that:**
- (a) the exposures arise with the same *counterparty*; and**
 - (b) the *firm* has a written agreement supported by a legal opinion obtained in accordance with rule 3-170(11).**

Sub-total

- 3-182(5)** R **The sum of the amounts calculated in accordance with this rule is the *CRR* for other amounts owed to the *firm* arising out of *investment business or investment dealing activities***

Consolidated Supervision

Under the Financial Conglomerates and Other Financial Groups Instrument 2004, the rules in Chapter 14 shall (with respect to a particular firm, group or financial conglomerate) apply from the first day of its financial year beginning in 2005 in place of rules 3-190(1) to 3-195.

3-190(1) R [deleted]

3-190(2) R [deleted]

G [deleted]

3-190(3) R [deleted]

3-190(4) R [deleted]

G [deleted]

3-191(1) R [deleted]

3-192(2) G [deleted]

G [deleted]

3-192(3) R [deleted]

3-192(4) R [deleted]

G [deleted]

3-193(1) R [deleted]

3-193(2) R [deleted]

3-193(3) R [deleted]

3-193(4) R [deleted]

G [deleted]

3-193(5) G [deleted]

- 3-194** R [deleted]
- 3-195** R [deleted]
- 3-300** ACMPs
- 3-300(1)** R **A *firm* may only use an *ACMP* for the purposes of rules 3-170 to 3-182 if:**
- (a) the policies and procedures making up the proposed *ACMP* are at all times adequate and appropriate to the *firm* and its business; and**
 - (b) the *firm* gives to the *FSA* at least three months' notice in writing of its intention to use an *ACMP* for the purposes of these rules.**
- 3-300(2)** R **The notice referred to in (1)(b) above must include all relevant details of the policies and procedures making up the proposed *ACMP*.**
- 3-300(3)** R **The notice referred to in (1)(b) is not required if the *firm* was permitted under the relevant requirements of a predecessor regulator, as they were in force immediately prior to the specified day, to use the proposed *ACMP* for the purposes of those requirements.**
- 3-300(4)** E
- (a) A *firm*'s policies and procedures should take full account of the principles described in Appendix 56.**
 - (b) Compliance with 3-300(4)(a) may be relied on as tending to establish compliance with 3-300(1)(a).**
 - (c) Contravention of 3-300(4)(a) may be relied on as tending to establish contravention of 3-300(1)(a).**
- G On receipt of notice under (1)(b) the *FSA* is likely to review the policies and procedures proposed by the *firm* and the degree to which they take full and appropriate account of the matters described in Appendix 56. The *FSA*'s review will take account of the context in which the policies and procedures are to operate and the relevant circumstances of the *firm*. The *FSA* will indicate to the *firm* its views on the adequacy and appropriateness of the proposals in the light of its review and may make recommendations of improvements.
- G The *FSA* may make a further review of the policies and procedures making up an *ACMP* at any time after their implementation for the purposes of these rules as part of its supervision of the *firm*. Any review after implementation will broadly follow the lines described above.

APPENDIX 1 – GLOSSARY OF TERMS FOR IPRU(INV) 3

If a defined term does not appear in the IPRU(INV) glossary below, the definition appearing in the main Handbook *Glossary* applies.

- acceptable collateral* means any of the following items of collateral provided to a *firm* by a *counterparty* -
- (a) cash;
 - (b) letters of credit and guarantees to the extent of their face value, issued by a *regulated banking institution* which is not the *counterparty* nor an *associate* of the *counterparty*;
 - (c) letters of credit and guarantees to the extent of their face value, issued by a bank which is not a *regulated banking institution* (not being the *counterparty*, an *associate* of the *counterparty* nor an *affiliated company*) which has been accepted under the *firm's ACMP*;
 - (d) gold and silver bullion and coinage; and
 - (e) *marketable investments*,
- to which the following conditions apply -
- (i) the *firm* must have an unconditional right to apply or realise the *acceptable collateral* for the purpose of repaying the *counterparty's* obligations;
 - (ii) *marketable investments* must -
 - (aa) be *marked to market* daily using the valuation principles in rule 3-41(9);
 - (bb) not be issued by the *counterparty* nor by an *associate* of the *counterparty*; and
 - (cc) be discounted by 8% (before allowances for hedging or diversification); and
 - (iii) each item of *acceptable collateral* must be discounted by 5% if it is denominated in a different currency to the *counterparty's* obligation;
- ACMP* means, subject to rule 3-300, a credit management policy and procedures according with the principles discussed in **Appendix 56**;
- Act* means the Financial Services and Markets Act 2000;
- adequately secured* means secured by cash or by *marketable investments* -
- (a) in respect of which the firm has an unconditional right to apply or realise for the purpose of repaying the

	<p><i>counterparty's</i> obligations to the <i>firm</i>;</p> <p>(b) which, in the case of <i>marketable investments</i>, are marked to market daily by the <i>firm</i> using the valuation principles in rule 3-41(9);</p> <p>(c) with, in the case of <i>marketable investments</i>, a marked to market value not lower than the current value of that obligation after being discounted -</p> <p style="padding-left: 40px;">(i) by 8% (before allowances for hedging or diversification); and</p> <p style="padding-left: 40px;">(ii) at an additional 5% if it is denominated in a different currency to the obligation; and</p> <p>(d) which, in the case of <i>marketable investments</i>, must not be issued by the <i>counterparty</i> nor by an <i>associate</i> of the <i>counterparty</i>;</p>
<i>adviser</i>	<p>means a <i>firm</i> which -</p> <p>(a) has <i>counterparties</i> who are investors or potential investors;</p> <p>(b) restricts its <i>investment business</i> to activities within article 53 (advising on investments) of the <i>Regulated Activities Order</i>;</p> <p>(c) does not hold, receive or control money or property belonging to another person, nor has a mandate over a <i>customer's</i> bank account;</p> <p>(d) does not introduce its <i>counterparties</i> to other persons as its main business; and</p> <p>(e) does not deal as principal or <i>agent</i> in <i>investments</i> or <i>physical commodities</i>;</p>
<i>affiliated company</i>	in relation to a <i>firm</i> , means any <i>body corporate</i> controlled by the <i>firm</i> , any parent company of the <i>firm</i> , and any <i>body corporate</i> controlled by a parent company of the <i>firm</i> ;
<i>agency broker</i>	means a <i>broad scope firm</i> which deals as principal only on an incidental basis;
<i>agent</i>	in relation to a person, means any person (including an <i>employee</i>) who acts on that person's behalf;
<i>allotment date</i>	means the date on which allotments are first made in respect of the <i>securities</i> being offered;
<i>annual accounting reference date</i>	means the date as at which the <i>annual financial statements</i> are prepared as initially notified by the <i>firm</i> to the <i>FSA</i> or as subsequently notified under rule rule 3-31 for all other purposes and which may not be more than 55 weeks since the previous

	<i>annual accounting reference date</i> or, if applicable, the date on which the <i>firm</i> commenced trading;
<i>annual financial statements</i>	means statements drawn up in accordance with Schedule 4 to the Companies Act 1985 or, where applicable, <i>international accounting standards</i> as at the <i>firm's annual accounting reference date</i> and, where required, an <i>auditor's report</i> ;
<i>appointed representative</i>	(in accordance with section 39 of the <i>Act</i>) means a person (other than an <i>authorised person</i>) who: <ul style="list-style-type: none"> (a) is a party to a contract with an <i>authorised person</i> (his principal) which: <ul style="list-style-type: none"> (i) permits or requires him to carry on business of a description prescribed in the Financial Services and Markets Act 2000 (Appointed Representatives) Regulations 2001 (SI 2001/1217); and (ii) complies with the requirements prescribed in those Regulations; and (b) is someone for whose activities in carrying on the whole or part of that business his principal has accepted responsibility in writing;
<i>approved bank</i>	(in relation to a bank account opened by a <i>firm</i>) means: <ul style="list-style-type: none"> (a) if the account is opened at a branch in the <i>United Kingdom</i>: <ul style="list-style-type: none"> (i) the Bank of England; or (ii) the central bank of a member state of the <i>OECD</i>; or (iii) a <i>bank</i>; or (iv) a <i>building society</i> which offers, unrestrictedly, banking services; or (v) a bank which is supervised by the central bank or other banking regulator of a member state of the <i>OECD</i>; or (b) if the account is opened elsewhere: <ul style="list-style-type: none"> (i) a bank in (a); or (ii) a <i>credit institution</i> established in an <i>EEA State</i> other than the United Kingdom and duly authorised by the relevant <i>Home State regulator</i>; or (iii) a bank which is regulated in the Isle of Man or the Channel Islands; or (c) a bank supervised by the South African Reserve Bank; or (d) any other bank that:

- (i) is subject to regulation by a national banking regulator;
- (ii) is required to provide audited accounts;
- (iii) has minimum net assets of £5 million (or its equivalent in any other currency at the relevant time) and has a surplus revenue over expenditure for the last two financial years; and
- (iv) has an annual audit report which is not materially qualified;

approved bank bond means any instrument, by whatever name called, provided by an *approved bank* which -

- (a) provides for the immediate payment of a stated sum to the *firm* on demand whether by the *firm* or the *FSA*;
- (b) provides that the bank shall have no recourse to the assets of the *firm* in respect of the bond and that no other person shall have recourse to the assets of the *firm* arising in respect of the bond, until payment in full of all other creditors;
- (c) prohibits the bank from terminating the bond unless -
 - (i) the beneficiary will have *financial resources* equal to at least 120% of its *financial resource requirement* after termination; or
 - (ii) receives authority from the *FSA* to do so;
- (d) prohibits any automatic early termination of the bond whether arising out of any act or default of the *firm* or otherwise;

approved exchange means an investment exchange listed as such in **Appendix 33**;

approved person means a *person* in relation to whom the *FSA* has given its approval under section 59 of the *Act* (Approval for particular arrangements) for the performance of a controlled function;

approved treasury arrangement means an arrangement notified to the *FSA* in writing whereby a group of *connected companies* including the *firm* transfers all cash surpluses to one specified *connected company* of the *firm* for the sole purpose of obtaining preferential interest rates on money market deposits;

arranger means a *firm* -

- (a) whose sole *investment business* consists of activities within the following articles of the Regulated Activities Order -

- (i) articles 14 (dealing in investments as principal) or 21 (dealing in investments as agent) if -
 - (aa) the *firm* is a *venture capital firm*; or
 - (bb) the activity is own account business which would be excluded from being *investment business* by the provisions of article 16 of the Regulated Activities Order but for the fact that the *firm* is an *authorised person*; or
- (ii) article 25(1) (arranging deals in investments);
- (iii) article 37 (managing investments); and
- (iv) article 49 (advising on investments);
- (b) whose *permission* is subject to a *limitation* or *requirement* preventing it from holding money or property belonging to other persons and does not have a mandate over a *customer's* bank account;

associate

in relation to a person ("A"), means -

- (a) an undertaking in the same *group* as A;
- (b) an *appointed representative* of A or of any undertaking in the same *group* as A; and
- (c) any other person whose business or domestic relationship with A or its *associate* might reasonably be expected to give rise to a community of interest between them which may involve a conflict of interest in dealings with third parties;

associated business

means business which is carried on in connection with *investment business*;

auditor's report

means a report drawn up in the format required by the *Supervision manual* which a *firm* must submit to the *FSA* in conjunction with the *firm's annual financial statements*;

authorised person

means (in accordance section 31 of the *Act* (Authorised persons)), one of the following:

- (a) a *person* who has a *Part IV permission* to carry on one or more *regulated activities*;
- (b) an *incoming EEA firm*;
- (c) an incoming *Treaty firm*;
- (d) a *UCITS qualifier*;
- (e) an *ICVC*;

	(f) the <i>Society of Lloyd's</i> ;
<i>authorised unit trust scheme</i>	means a <i>collective investment scheme</i> authorised for the purposes of the <i>Act</i> ;
<i>body corporate</i>	means (in accordance with section 417(1)(Definitions))any body corporate, including a body corporate constituted under the law of a country or territory outside the United Kingdom, of the <i>Act</i> ;
<i>bonus</i>	means that part of the remuneration paid by a firm to its <i>employees</i> (including <i>directors</i>) which is: <ul style="list-style-type: none"> (a) not a <i>profit share</i>; and (b) awarded by management entirely on a discretionary basis, to the extent that it does not exceed the profit for the financial year of the <i>firm</i> before accounting for such bonus;
<i>bought deal</i>	means an <i>offering</i> where a <i>firm</i> on its own gives an outright binding commitment to the issuer or seller to purchase or subscribe for the <i>securities</i> to be offered;
<i>broad scope firm</i>	means any <i>firm</i> which is not an <i>adviser</i> , an <i>arranger</i> or a <i>local</i> ;
<i>business day</i>	means any day, except Saturday, Sunday, bank holidays and public holidays (not being bank holidays);
<i>buy and sale back agreement</i>	see <i>reverse repurchase agreement</i> ;
<i>call option</i>	means an <i>option</i> to buy an <i>investment</i> , other instrument, foreign currency or <i>physical commodity</i> at a given price on or before a given date;
<i>cap</i>	means an agreement in respect of a borrowing under which a <i>counterparty</i> contracts to pay any interest costs arising as a result of an increase in rates above an agreed rate: the effect being to provide protection to the holder against a rise above that agreed rate;
<i>category D firm</i>	means a <i>firm</i> , the only <i>core investment service</i> for which it has <i>permission</i> is receiving and transmitting on behalf of investors orders in relation to one or more of the instruments listed in Section B of the Annex to the <i>ISD</i> , and whose <i>permission</i> is subject to a <i>limitation</i> or <i>requirement</i> preventing it from holding <i>client money</i> or <i>clients' assets</i> and for that reason may not at any time place itself in debit with its <i>clients</i> , which benefits from the freedom of establishment or to provide services under Articles 14 or 15 of the <i>ISD</i> ;
<i>certificate of deposit</i>	means a negotiable or non-negotiable certificate issued by a bank;
<i>clearing firm</i>	means a <i>firm</i> which accepts primary responsibility (including legal

	liability) for the settlement of transactions for <i>counterparties</i> ;
<i>clearing house</i>	means a clearing house through which transactions on an <i>exchange</i> may be cleared;
<i>client</i>	means any <i>person</i> with or for whom a <i>firm</i> conducts or intends to conduct <i>designated investment business</i> or any other <i>regulated activity</i> ; and: <ul style="list-style-type: none"> (a) every client is a <i>customer</i> or a <i>market counterparty</i>; (b) "client" includes: <ul style="list-style-type: none"> (i) a potential client; (ii) a client of an <i>appointed representative</i> of a <i>firm</i> with or for whom the <i>appointed representative</i> acts or intends to act in the course of business for which the <i>firm</i> has accepted responsibility under section 39 of the <i>Act</i> (Exemption of appointed representatives); (iii) a <i>collective investment scheme</i> even if it does not have separate legal personality; (iv) if a <i>person</i> ("C1"), with or for whom the <i>firm</i> is conducting or intends to conduct <i>designated investment business</i>, is acting as agent for another <i>person</i> ("C2"), either C1 or C2 in accordance with COB 4.1.5R (Agent as client); (c) "client" does not include: <ul style="list-style-type: none"> (i) a trust beneficiary; (ii) a <i>corporate finance contact</i>; (iii) a <i>venture capital contact</i>.
<i>client money</i>	subject to the <i>client money rules</i> , means <i>money</i> of any currency which, in the course of carrying on <i>designated investment business</i> , a <i>firm</i> holds in respect of any <i>investment agreement</i> entered into, or to be entered into, with or for a <i>client</i> , or which a <i>firm</i> treats as <i>client money</i> in accordance with the <i>client money rules</i> ;
<i>client money rules</i>	means CASS 4.1 to 4.3;
<i>close relative</i>	in relation to a person, means the person's spouse or civil partner, his children and step-children, his parents and step-parents, his brothers and sisters and his step-brothers and step-sisters;
<i>closing date</i>	means the date on which payment for the <i>securities</i> is due to be made to the issuer or seller, or, if payment is made in

	instalments, payment of the first instalment;
<i>collective investment scheme</i>	means a collective investment scheme, as defined in section 235 of the <i>Act</i> (Collective Investment Schemes), which is in summary: <ul style="list-style-type: none"> (a) any arrangements with respect to property of any description, including money, the purpose or effect of which is to enable <i>persons</i> taking part in the arrangements (whether by becoming owners of the property or any part of it or otherwise) to participate in or receive profits or income arising from the acquisition, holding, management or disposal of the property or sums paid out of such profits or income; and (b) which are not excluded by the Financial Services and Markets Act (Collective Investment Schemes) Order 2001 (SI 2001/1062);
<i>commissions shared</i>	means that part of the remuneration paid by a <i>firm</i> which is determined on the basis of the number, size or profitability of individual deals carried out;
<i>connected company</i>	and " <i>connected credit institution</i> " mean, in relation to a <i>firm</i> which: <ul style="list-style-type: none"> (a) is a <i>body corporate</i>, a <i>body corporate</i> or <i>credit institution</i> satisfying any of the following conditions - <ul style="list-style-type: none"> (i) the same person is the <i>controller</i> of each <i>body corporate</i> or <i>credit institution</i>; (ii) if a group of two or more persons are <i>controllers</i> of each <i>body corporate</i> or <i>credit institution</i> and the group either consists of the same persons or could be regarded as consisting of the same persons by treating a member of either group as replaced by - <ul style="list-style-type: none"> (aa) that member's <i>close relative</i>; (bb) a person with whom that member is in partnership; or (cc) a <i>body corporate</i> of which the member is an officer; or (iii) both <i>bodies corporate</i> are members of the same group; or (b) is not a <i>body corporate</i>, a <i>body corporate</i> or <i>credit institution</i> which is controlled - <ul style="list-style-type: none"> (i) by the <i>firm</i>; (ii) by a <i>partner</i> in the <i>firm</i>; (iii) by a <i>close relative</i> of a <i>partner</i> in the <i>firm</i> or, if the <i>firm</i> is a <i>sole trader</i>, by a <i>close relative</i> of the <i>sole</i>

trader, or

- (iv) collectively by any of the *partners* in the *firm* or their *close relatives*;

connected credit institution

see “*connected company*”;

connected person

has the same meaning as given in section 346 of the Companies Act 1985 and a person described therein as being connected with a *director* will similarly be deemed to be connected with a *partner* of a *firm*;

contingency

means a future event the outcome of which is uncertain;

contingent liability

means a liability dependent upon the occurrence or non-occurrence of one or more uncertain future events;

contract for differences

means (as specified in article 85 of the Regulated Activities Order (Contracts for differences etc)), rights under:

- (a) a contract for differences; or
- (b) any other contract the purpose or pretended purpose of which is to secure a profit or avoid a loss by reference to fluctuations in:
 - (i) the value or price of property of any description; or
 - (ii) an index or other factor designated for that purpose in the contract;

controller

means -

- (a) in relation to a *body corporate* -
 - (i) a person, who alone or with any *associate* or *associates*, has a direct or indirect holding in the *body corporate* which represents 10% or more of the capital or of the voting rights; and
 - (ii) any person who has a direct or indirect holding in the *body corporate* which makes it possible to exercise a significant influence over the management of the *body corporate*; and
- (b) in relation to an unincorporated association -
 - (i) any person in accordance with whose directions or instructions the officers of the association are accustomed to act (but disregarding advice given in a professional capacity);
 - (ii) any person who is entitled to exercise, or control the exercise of, 10% or more of the voting power at any

general meeting of the association; and

- (iii) any person who has a direct or indirect holding in the association which makes it possible to exercise a significant influence over the management of the association;

and “*control*” shall be construed accordingly;

convertible

means a *security* which gives the investor the right to convert the *security* into equity at an agreed price or on an agreed basis;

core investment service

means a service listed in Section A of the Annex to the *ISD* the text of which is set out in Schedule 2 of the Regulated Activities Order;

corporate finance advisory firm

means a *firm* which is an *arranger* and whose *permission* includes a *requirement* that it must not conduct *investment business* other than *corporate finance business*;

corporate finance business

means –

- (a) *designated investment business* carried on by a *firm* with or for:
 - (i) any *issuer*, holder or owner of *designated investments*, if that business relates to the *offer*, issue, underwriting, repurchase, exchange or redemption of, or the variation of the terms of, those *investments*, or any related matter;
 - (ii) any *market counterparty* or *intermediate customer*, or other *body corporate*, *partnership* or supranational organisation, if that business relates to the manner in which, or the terms on which, or the *persons* by whom, any business, activities or undertakings relating to it, or any *associate*, are to be financed, structured, managed, controlled, regulated or reported upon;
 - (iii) any *person* in connection with:
 - (A) a proposed or actual *takeover* or *related operation* by or on behalf of that *person*, or involving *investments* issued by that *person* (being a *body corporate*), its *holding company*, *subsidiary* or *associate*; or
 - (B) a merger, de-merger, reorganisation or reconstruction involving any *investments* issued by that *person* (being a *body corporate*), its *holding company*, *subsidiary* or *associate*;
 - (iv) any shareholder or prospective shareholder of a *body*

corporate established or to be established for the purpose of effecting a *takeover or related operation*, where that business is in connection with that *takeover or related operation*;

- (v) any *person* who, acting as a *principal* for his own account:
 - (A) is involved in negotiations or decisions relating to the commercial, financial or strategic intentions or requirements of a business or prospective business; or
 - (B) (provided he is acting otherwise than solely in his capacity as an investor) assists the interests of another *person* with or for whom the *firm*, or another *authorised person* or *overseas person*, is undertaking business as specified in (a)(i),(ii),(iii) or (iv), by himself undertaking all or part of any transactions involved in such business;
- (vi) any *person* undertaking business with or for a *person* as specified in (a)(i), (ii), (iii), (iv) or (v) in respect of activities described in those sub-paragraphs;
- (b) *designated investment business* carried on by a *firm* as a *principal* for its own account where such business:
 - (i) is in the course of, or arises out of, activities undertaken in accordance with (a); and
 - (ii) does not involve transactions with or for, or *advice on investments* to, any other *person* who is a *private customer* in respect of such business;
- (c) *designated investment business* carried on by a *firm* as *principal* for its own account if such business:
 - (i) is in the course of, or arises out of:
 - (A) the *offer*, issue, underwriting, repurchase, exchange or redemption of, or the variation of the terms of, *shares*, share warrants, *debentures* or debenture warrants issued by the *firm*, or any related matter; or
 - (B) a proposed or actual *takeover or related operation* by or on behalf of the *firm*, or involving *shares*, share warrants, *debentures* or debenture warrants issued by the *firm*; or
 - (C) a merger, de-merger, reorganisation or reconstruction involving any *shares*, share

warrants, *debentures* or debenture warrants issued by the *firm*; and

- (ii) does not involve giving *advice on investments* to any person who is a *private customer*;

in this definition, “share warrants” and “debenture warrants” mean any *warrants* which relate to *shares* in the *firm* concerned or, as the case may be, *debentures* issued by the *firm*;

<i>counterparty</i>	means any person with or for whom a <i>firm</i> carries on, or intends to carry on, any <i>regulated business</i> or <i>associated business</i> ;
<i>CRR</i>	means the counterparty risk requirement, as calculated 3-170 to 3-182;
<i>customer</i>	means a <i>client</i> who is not a <i>market counterparty</i> ;
<i>dealing activities</i>	means all <i>dealing activities</i> as principal or <i>agent</i> in <i>investments</i> and <i>physical commodities</i> ;
<i>debenture</i>	means the investment specified in article 77 of the Regulated Activities Order (Instruments creating or acknowledging indebtedness), which is in summary: any of the following which are not <i>government and public securities</i> : (a) debentures; (b) debenture stock; (c) loan stock; (d) bonds; (e) certificates of deposit; (f) any other instruments creating or acknowledging indebtedness;
<i>dematerialised instruction transmitter</i>	means a firm - (a) which restricts its <i>investment business</i> to activities within article 45 (sending dematerialised instructions) of the Regulated Activities Order; and (b) which does not hold or receive money or property belonging to another person nor has a mandate over another person’s bank account;
<i>derivatives</i>	means <i>options</i> , <i>futures</i> and <i>contracts for differences</i> ;
<i>derivative fund manager</i>	means an <i>arranger</i> - (a) whose <i>investment business</i> consists of discretionary management of funds which are invested predominately in

	<i>derivatives</i> ; and
	(b) whose income is not related to the volume of business transacted on behalf of the funds managed by him;
<i>designated investment exchange</i>	means any investment exchange which is defined as such in the central Handbook Glossary;
<i>director</i>	in relation to a <i>body corporate</i> includes -
	(a) any person occupying the position of <i>director</i> by whatever name called;
	(b) any person in accordance with whose directions or instructions (not being advice given in a professional capacity) the <i>directors</i> are accustomed to act; or
	(c) in the case of an <i>overseas firm</i> , any person who occupies a position analogous to that of a <i>director</i> of a company registered under the Companies Act 1985;
<i>documents of title</i>	means documents of title and documents evidencing title to <i>investments</i> and commodities;
<i>domestic offering</i>	means an <i>offering</i> or a tranche of an <i>offering</i> which is directed primarily to investors in the United Kingdom and which uses methods normal in the United Kingdom domestic capital markets;
<i>dual currency bonds</i>	means debt securities, the issue price and coupon of which are fixed in one currency whilst the redemption value is fixed in a different currency;
<i>EEA</i>	means the area established by the agreement on the European Economic Area signed at Oporto on 2 May 1992 and which consists of the <i>EEA States</i> ;
<i>EEA State</i>	see definition of <i>EEA State</i> in the <i>Glossary</i>
<i>eligible capital substitute</i>	means a subordinated loan, <i>approved bank bond</i> or approved undertaking which a <i>firm</i> may treat as an <i>eligible capital substitute</i> in accordance with rule 3-63;
<i>employee</i>	in relation to any person, means an individual -
	(a) who is employed by that person under a contract of service, a contract for services, or any other contract under which the individual will provide services to the person;
	(b) who is a <i>director</i> of the person where the person is a <i>body corporate</i> ;
	(c) who is a <i>partner</i> of the person where the person is a partnership;
	(d) who, where the person is an unincorporated association, is a member of its governing body, the secretary or treasurer;

	or
	(e) whose services are, under an arrangement between the person and a third party, placed at the disposal and under the control of the person;
<i>equity balance</i>	means - (a) a <i>counterparty's equity balance</i> ; or (b) a <i>firm's equity balance</i> ;
<i>European Communities</i>	means Euratom (European Atomic Energy Community), the European Coal and Steel Community and the European Economic Community;
<i>exceptional items</i>	means those items which derive from events or transactions within the ordinary activities of the business of a <i>firm</i> and which are both material and not expected to recur frequently or regularly;
<i>exchange</i>	means a <i>recognised investment exchange</i> or <i>designated investment exchange</i> ;
<i>exchange traded</i>	means an <i>investment</i> which is traded or listed <i>on exchange</i> or on an <i>approved exchange</i> ; or an <i>offering</i> where an investment <i>pari passu</i> to that being offered is traded or listed <i>on exchange</i> or on an <i>approved exchange</i> ;
<i>exchange-traded-margined-transaction</i>	means a <i>margined transaction</i> effected by a <i>firm</i> under the rules of an <i>exchange</i> or an <i>approved exchange</i> or <i>clearing house</i> ;
<i>extraordinary items</i>	means those items which derive from events or transactions outside the ordinary activities of the business of a <i>firm</i> and which are both material and not expected to recur frequently or regularly;
<i>financial bookmaker</i>	means a <i>firm</i> which conducts only spread-betting business;
<i>financial reporting statement</i>	means the periodic financial and other reporting statements required to be provided to the <i>FSA</i> under the provisions of Chapter 16 of the <i>Supervision manual</i> ;
<i>financial resources</i>	means the sum of the <i>firm's tangible net worth</i> and <i>eligible capital substitutes</i> ;
<i>financial resources requirement</i>	means the sum of the <i>firm's primary requirement</i> , <i>PRR</i> and <i>CRR</i> ;
<i>financial rules</i>	means the financial rules in Chapter 3 of the <i>FSA's Interim Prudential Sourcebook for Investment Businesses (IPRU(INV)3)</i> ;
<i>firm</i>	means an <i>authorised person</i> ;
<i>floor</i>	means an agreement in respect of a deposit under which a

	<i>counterparty</i> contracts to pay any lost income arising as a result of a fall in rates below an agreed rate: the effect being to provide protection to the holder against a fall below that agreed interest rate;
<i>foreign currency derivatives method</i>	means the method of calculating <i>PRR</i> under rule 3-153;
<i>foreign currency exposures method</i>	means the method of calculating <i>PRR</i> under rule 3-154;
<i>forward</i>	means a <i>security</i> which is transacted for a settlement date beyond that which would normally apply in the market concerned, and where that forward settlement date is not yet passed;
<i>FRA</i>	means <i>forward</i> rate agreement, i.e. an agreement in which two parties agree on the payment by one party to another of an amount of interest based on an agreed interest rate for a specified period from a specified settlement date applied to an agreed principal amount; no commitment is made by either party to lend or borrow the principal amount; their exposure is only the interest difference between the agreed and actual rates at settlement;
<i>free delivery</i>	means - <ul style="list-style-type: none"> (a) the delivery of <i>securities</i> or <i>physical commodities</i> which takes place before the seller receives payment; or (b) payment made in settlement of a credit balance arising from a sale on behalf of, or a purchase from a counterparty in respect of which the <i>securities</i> are undelivered;
<i>FRN</i>	means floating rate note, i.e. all debt <i>securities</i> which pay interest at a rate which varies in response to general interest rates (including floating rate collateralised mortgage obligations);
<i>FSA</i>	means the Financial Services Authority;
<i>future</i>	means the investment, specified in article 84 of the Regulated Activities Order (Futures), which is, in summary: rights under a contract for the sale or delivery of a commodity or property of any other description under which delivery is to be made at a future date and at a price agreed on when the contract is made;
<i>geared futures and options fund</i>	means an <i>authorised fund</i> dedicated to <i>derivatives</i> (where most or all of the extent of investment is limited by the amount of property available to be put up as initial outlay), whether with or without <i>transferable securities</i> ;
<i>government & public securities</i>	means the <i>investment</i> , specified in article 78 of the <i>Regulated Activities Order</i> (Government and public securities), which is in

summary: a loan stock, bond or other instrument creating or acknowledging indebtedness, issued by or on behalf of any of the following:

- (a) the government of the United Kingdom; or
- (b) the Scottish Administration; or
- (c) the Executive Committee of the Northern Ireland Assembly;
or
- (d) the National Assembly of Wales; or
- (e) the government of any country or territory outside the United Kingdom; or
- (f) a local authority in the United Kingdom or elsewhere; or
- (g) a body the members of which comprise:
 - (i) states including the United Kingdom or another *EEA State*; or
 - (ii) bodies whose members comprise states including the United Kingdom or another *EEA State*;

but excluding:

- (A) the instruments specified in article 77(2)(a) to (d) of the *Regulated Activities Order*;
- (B) any instrument creating or acknowledging indebtedness in respect of:
 - (I) money received by the Director of Savings as *deposits* or otherwise in connection with the business of the National Savings Bank; or
 - (II) money raised under the National Loans Act 1968 under the auspices of the Director of Savings or treated as so raised under section 11(3) of the National Debt Act 1972;

group

except in relation to a *marketing group*, means (in accordance with section 421 of the Act (Group)), in relation to a person ("A"), A and any person who is:

- (a) a parent undertaking of A;
- (b) a subsidiary undertaking of A;

- (c) a subsidiary undertaking of a parent undertaking of A;
- (d) a parent undertaking of a subsidiary undertaking of A;
- (e) an undertaking in which A or an undertaking in (a) to (d) has a participating interest;
- (f) if A or an undertaking in (a) or (d) is a *building society*, an associated undertaking of that *building society*;
- (g) if A or an undertaking in (a) or (d) is an *incorporated friendly society*, a *body corporate* of which that *friendly society* has joint control (as defined in section 13(9)(c) or (cc) of the Friendly Societies Act 1992);

in this definition:

- (i) "participating interest" has the same meaning as in Part VII of the Companies Act 1985 or Part VIII of the Companies (Northern Ireland) Order 1986; but also includes an interest held by an individual which would be a participating interest for the purposes of those provisions if he were an undertaking;
- (ii) "associated undertaking" has the meaning given in section 119(1) of the Building Societies Act 1986.

<i>holding company</i>	has the meaning given to it in section 736 of the Companies Act 1985;
<i>in the money</i>	means, in relation to <i>call options</i> and <i>warrants</i> , that the exercise price is less than the current <i>mark to market</i> value of the <i>underlying instrument</i> and, in relation to <i>put options</i> , that the current <i>mark to market</i> value is less than the exercise price;
<i>incoming EEA firm</i>	means (in accordance with section 193(1)(a) of the <i>Act</i> (Interpretation of this Part)) an <i>EEA firm</i> which is exercising, or has exercised, its right to carry on a <i>regulated activity</i> in the <i>United Kingdom</i> in accordance with Schedule 3 to the <i>Act</i> (EEA Passport Rights).
<i>initial margin requirement</i>	means the total amount which under the rules of the relevant <i>exchange</i> or <i>exchanges</i> or <i>clearing house</i> or <i>clearing houses</i> the <i>firm</i> or an <i>intermediate broker</i> would be required to deposit in cash as a fidelity deposit in respect of all the <i>client's</i> open positions in <i>margined transactions</i> at that time, irrespective of any unrealised profit or loss on such positions, on the assumption that those transactions were the only transactions undertaken under the rules of that <i>exchange</i> or those <i>exchanges</i> or that <i>clearing house</i> or those <i>clearing houses</i> by the <i>firm</i> or the <i>intermediate broker</i> at that time;
<i>intermediate broker</i>	in relation to a <i>margined transaction</i> , means any person through

whom the *firm* undertakes that transaction;

intermediate customer means a *client* who is not a *market counterparty* and who is:

- (a) a local authority or public authority;
- (b) a *body corporate* whose *shares* have been *listed* or *admitted to trading* on any *EEA* exchange;
- (c) a *body corporate* whose *shares* have been *listed* or *admitted to trading* on the primary board of any *IOSCO* member country official exchange;
- (d) a *body corporate* (including a *limited liability partnership*) which has (or any of whose *holding companies* or *subsidiaries* has) (or has had at any time during the previous two years) called up share capital or net assets of at least £5 million (or its equivalent in any other currency at the relevant time);
- (e) a *special purpose vehicle*;
- (f) a *partnership* or unincorporated association which has (or has had at any time during the previous two years) net assets of at least £5 million (or its equivalent in any other currency at the relevant time) and calculated in the case of a *limited partnership* without deducting loans owing to any of the *partners*;
- (g) a trustee of a trust (other than an *occupational pension scheme*, *SSAS* or *stakeholder pension scheme*) which has (or has had at any time during the previous two years) assets of at least £10 million (or its equivalent in any other currency at the relevant time) calculated by aggregating the value of the cash and *designated investments* forming part of the trust's assets, but before deducting its liabilities;
- (h) a trustee of an *occupational pension scheme*, *SSAS* or *stakeholder pension scheme* where the trust has (or has had at any time during the previous two years):
 - (i) at least 50 members; and
 - (ii) assets under management of at least £10 million (or its equivalent in any other currency at the relevant time);
- (i) another *firm*, or an *overseas financial services institution*, when, in relation to *designated investment business*, or related *ancillary activities*, conducted with or for that *firm* or institution, that *firm* or institution is an *intermediate customer* in accordance with *COB*

4.1.7R (Classification of another firm or an overseas financial services institution);

- (j) an *unregulated collective investment scheme*;
- (k) a *client* when he is classified as an *intermediate customer* in accordance with COB 4.1.9R (Expert private customer classified as intermediate customer);

but excluding:

- (A) a *regulated collective investment scheme*; and
- (B) a *client* who would otherwise be an *intermediate customer*, when he is classified in accordance with:
 - (I) COB 4.1.12R (Large intermediate customer classified as market counterparty); or
 - (II) COB 4.1.14R (Client classified as private customer);

internal controls

means the whole system of controls, financial or otherwise, established by the management in order to -

- (a) carry on the business of the *firm* in an orderly and efficient manner;
- (b) ensure adherence to management policies;
- (c) safeguard the assets of the *firm* and assets for which the *firm* is responsible belonging to *customers* and other persons; and
- (d) secure as far as possible the completeness and accuracy of the *firm's* records (including those necessary to ensure continuous compliance with the requirements for financial resources under the rules of the *FSA*);

international offering

means an *offering* which is not a *domestic offering* or, where an *offering* has a tranche which is a *domestic offering*, those tranches which are not;

introducing broker

means an *arranger* who introduces all transactions in *investment business* or *dealing activities* arranged for *counterparties* to a *clearing firm* where the *clearing firm* accepts primary responsibility (including legal liability) for the settlement of those transactions;

investment

means (for the purposes of this chapter) any of the following investments specified in Part III of the Regulated Activities Order (Specified investments):

- (a) life policies (subset of article 75);

- (b) shares (article 76);
- (c) debentures (that is, instruments creating or acknowledging indebtedness) (article 77);
- (d) government and public securities (article 78);
- (e) warrants (that is, instruments giving entitlement to investments) (article 79);
- (f) certificates representing certain securities (article 80);
- (g) units (article 81);
- (h) stakeholder pension scheme (article 82);
- (i) options (article 83);
- (j) futures (article 84);
- (k) contracts for differences (article 85);
- (l) rights to or interests in an investment within (a) to (k) (article 89);¹

investment agreement means any agreement the making or performance of which by either party constitutes an activity which is *investment business*;

investment business means any of the following regulated activities specified in Part II of the Regulated Activities Order and which is carried on by way of business:

- (a) dealing in investments as principal (article 14), but disregarding the exclusion in article 15 (Absence of holding out etc);
- (b) dealing in investments as agent (article 21);
- (c) arranging deals in investments for another person (article 25(1)) but only in relation to *investments*;
- (d) making arrangements for deals in investments (article 25(2)) but only in relation to *investments*;
- (e) managing investments (article 37);
- (f) safeguarding and administration of assets (article 40);
- (g) sending dematerialised instructions (article 45(1));
- (h) causing dematerialised instructions to be sent (article 45(2));
- (i) establishing, operating or winding up a collective

¹ These are the same investments as are included in the definition of "designated investment" used in the main Handbook glossary.

	investment scheme (article 51(1)(a));
	(j) acting as trustee of an authorised unit trust scheme (article 51(1)(b));
	(k) acting as the depository or sole director of an open-ended investment company (article 51(1)(c));
	(l) advising on investments (article 53);
	(m) agreeing to carry on the activities in (a) to (h) and (l) (article 64); ²
<i>investment firm</i>	means any legal or natural person established in the <i>EEA</i> , the regular occupation or business of which is the provision of core <i>investment services</i> for third parties on a professional basis, in accordance with the <i>ISD</i> , excluding any person to whom the <i>ISD</i> does not apply by virtue of the provisions of paragraph 2 of article 2 of that directive;
<i>investment manager</i>	means a person who, acting only on behalf of a <i>customer</i> , either -
	(a) manages an account or portfolio in the exercise of discretion; or
	(b) has accepted responsibility on a continuing basis for advising on the composition of the account or portfolio;
<i>investment services</i>	means -
	(a) activities undertaken in the course of carrying on investment business; and
	(b) activities undertaken in connection with an <i>ISA</i> where those activities do not constitute investment business;
<i>ISA</i>	means an account which is a scheme of investment satisfying the conditions prescribed by the Individual Savings Account Regulations;
<i>launch</i>	means the time when any announcement, specifying the issuer or the guarantor of and indicating the final <i>pricing terms</i> of the <i>offering</i> is made for the first time to the public or the press or any <i>exchange</i> or <i>approved exchange</i> or information service;
<i>local</i>	means a <i>firm</i> which is a member of a futures and options exchange and whose <i>permission</i> includes a <i>requirement</i> that:
	(a) the <i>firm</i> will not conduct <i>designated investment business</i> other than:
	(i) <i>dealing</i> for its own account on that futures and options

² These are the same activities as are included in the definition of "designated investment business" used in the Main Handbook Glossary.

exchange;

- (ii) *dealing* for the accounts of other members of the same futures and options exchange; or
 - (iii) making a price to other members of the same futures and options exchange; and
- (b) the performance of the *firm's* contracts must be guaranteed by and must be the responsibility of one or more of the clearing members of the same futures and options exchange;

margined transaction means a transaction effected by a *firm* with or for a *customer* relating to an *investment* of any description referred to in articles 83, 84 and 85 of the Regulated Activities Order (or any right or any interest in such an *investment*) under the terms of which the *customer* will or may be liable to make a deposit in cash or collateral to secure performance of obligations which he may have to perform when the transaction falls to be completed or upon the earlier closing out of his position;

mark to market means to value an *investment* at its current market value in accordance with rule 3-41(9);

market counterparty means a *client* who is:

- (a) a properly constituted government (including a quasi-governmental body or a government agency) of any given country or territory;
- (b) a central bank or other national monetary authority of any country or territory;
- (c) a supranational whose members are either countries or central banks or national monetary authorities;
- (d) a State investment body, or a body charged with, or intervening in, the management of the public debt;
- (e) another *firm*, or an *overseas financial services institution*, except in relation to *designated investment business*, and related *ancillary activities*, conducted with or for that *firm* or institution, when that *firm* or institution is an *intermediate customer* in accordance with COB 4.1.7R (Classification of another firm or an overseas financial services institution);
- (f) any *associate* of a *firm* (except an *OPS firm*), or of an *overseas financial services institution*, if the *firm* or institution consents;
- (g) a *client* when he is classified as a *market counterparty* in accordance with COB 4.1.12R (Large intermediate

customer classified as a market counterparty);

but excluding:

- (A) a *collective investment scheme*; and
- (B) a *client*, who would otherwise be a *market counterparty*, when he is classified as a *private customer* in accordance with COB 4.1.14R (Client classified as private customer);

marketable investment means -

- (a) an *investment* which is traded on or under the rules of an *exchange* or an *approved exchange*;
- (b) a debt instrument which may be transferred without the consent of the issuer or any other person (including a collateralised mortgage obligation);
- (c) a *physical commodity*;
- (d) a *warrant, option, future* or other instrument which entitles the holder to subscribe for or acquire -
 - (i) an *investment* or *physical commodity* which falls under (a) to (c) above;
 - (ii) any currency; or
 - (iii) any combination of (i) and (ii) above;
- (e) a *contract for differences* (including interest rate and currency *swaps*) relating to fluctuations in -
 - (i) the value or price of an *investment* or *physical commodity* in (a) to (d) above;
 - (ii) any currency;
 - (iii) the rate of interest in any currency or any index of such rates;
 - (iv) the level of any index which is derived from the prices of an *investment* or *physical commodity* in (a) to (c) above; or
 - (v) any combination of (i) to (iv) above;
- (f) *warrants, options, futures* or other instruments entitling the holder to obtain the rights of those contracts in (d) or (e) above; and
- (g) a unit in a *regulated collective investment scheme*;

marketing group means a group of persons who -

- (a) are allied together (either formally or informally) for purposes of marketing *packaged products* of the group; and
- (b) each of whom, if it holds itself out in the United Kingdom as marketing any *packaged products* to private individuals (who are not acting in the course of *investment business*) or to others (who are not acting in the course of business of any kind), does so only as an *investment manager* or in relation to those of the *marketing group*;

<i>model A clearing firm</i>	means a <i>regulated clearing firm</i> which uses its own money for settlement but is reimbursed on a daily basis by the non-clearing firms it settles for;
<i>money</i>	includes cheques or other payable orders;
<i>money broker</i>	means a <i>firm</i> for which the total value of <i>repurchase, securities lending and sale and buy back agreements</i> is or has been at any time during the previous year, at least 25% of its total assets;*
<i>new securities</i>	means, in relation to a particular <i>offering</i> , <i>securities</i> which are issued pursuant or with a view to an <i>offering</i> ;
<i>new to the market</i>	means, in relation to an <i>offering</i> , <i>securities</i> which are not already <i>exchange traded</i> ;
<i>non clearing floor member</i>	means a <i>firm</i> which: <ul style="list-style-type: none"> (a) is authorised to trade on the floor of a <i>recognised investment exchange</i> which permits this category; (b) is not prohibited by the rules of that exchange from dealing with <i>customers</i>; (c) has entered in to an agreement with a <i>clearing firm</i> which accepts full responsibility for every deal entered into by the non clearing floor member; and (d) is not authorised to handle <i>client money</i>;
<i>non recourse loan</i>	means a loan to a <i>firm</i> secured on specific land or buildings, under the terms of which the lender has no claim on the other assets of the <i>firm</i> nor on assets for which the <i>firm</i> is accountable in any circumstances (including a winding up);
<i>note issuance facility</i>	means an arrangement under the terms of which a borrower is able to issue short term notes in its own name with a guarantor, or consortium of guarantors ensuring the availability of funds to the borrower by agreeing to purchase any unsold notes, and which includes for example revolving underwriting facilities, note

* For guidance notes on *money brokers*, see **Appendix 37**

	purchase facilities, euronote facilities and similar arrangements;
<i>OECD</i>	means the Organisation for Economic Co-operation and Development;
<i>offering</i>	means an offering of <i>securities</i> which are - <ul style="list-style-type: none"> (a) issued for the purpose of the offering; (b) <i>new to the market</i>; or (c) existing <i>securities</i> which are <i>exchange traded</i> subject to the purchase of those <i>securities</i> having the same characteristics as an <i>offering of new securities</i>, or <i>securities</i> which are <i>new to the market</i>;
<i>oil</i>	means mineral oil of any description and petroleum gases, whether in liquid or vapour form, and includes products and derivatives of oil;
<i>oil collective investment scheme</i>	means a <i>collective investment scheme</i> , the property of which consists only of property which is oil or an <i>oil investment</i> or cash awaiting investment;
<i>oil investment</i>	any of the following: <ul style="list-style-type: none"> (a) a unit in an <i>oil collective investment scheme</i>; (b) a <i>future</i> where the commodity in question is <i>oil</i>; (c) a <i>contract for differences</i> where the property in question is <i>oil</i> or an <i>oil investment</i> or the index or other factor in question is linked to or otherwise dependent upon fluctuations in the value or price of <i>oil</i> or any <i>oil investment</i>; (d) rights to and interests in anything which is an <i>oil investment</i>; (e) an option to acquire or dispose of an investment in (a) to (d);
<i>oil market investment activities</i>	means any <i>regulated activity</i> in relation to an <i>oil investment</i> or to <i>oil</i> ;
<i>oil market participant</i>	means a <i>firm</i> which: <ul style="list-style-type: none"> (a) carries on <i>oil market investment activities</i>, which in the United Kingdom are confined to either or both the following: <ul style="list-style-type: none"> (i) the performance of management services for the participants in an <i>oil collective investment scheme</i> in which individuals do not participate, and other <i>oil market investment activities</i> which are performed in relation to any such <i>oil collective investment</i>

scheme;

- (ii) other *oil market investment activities* which:
 - (A) are the executing of transactions on any *recognised investment exchange* or *designated investment exchange*, other than to enable the *firm* to fulfil the orders of *clients*; or
 - (B) if they are not the executing of transactions on such exchanges, are performed in connection with or for persons who are not individuals; and
- (b) whose *permission* includes a *requirement* that the *firm* must not carry on any *investment business* other than that in (a);

open-priced deal means an *international offering* which is not a *bought deal* or *pre-priced deal*;

operator means:

- (a) (in relation to an *AUT*) the *manager*;
- (b) (in relation to an *ICVC*) that *company* or, if applicable, the *authorised corporate director*;
- (c) (in relation to any other *collective investment scheme* that is a *unit trust scheme* with a separate *trustee*) any *person* who, under the *trust deed* establishing the *scheme*, is responsible for the management of the property held for or within the *scheme*;
- (d) (in relation to any other *collective investment scheme* that is an *open-ended investment company*) that *company* or, if applicable, any *person* who, under the constitution or founding arrangements of the *scheme*, is responsible for the management of the property held for or within the *scheme*;
- (e) (in relation to an *investment trust savings scheme*) any *person* appointed, by those responsible for managing the property of the *investment trust*, to manage the *investment trust savings scheme*;

option means the investment specified in article 77 of the Regulated Activities Order (Options), which is an option to acquire or dispose of:

- (a) a security or contractually based investment (other than an option);
- (b) currency of the United Kingdom or of any other country

	or territory;
	(c) palladium, platinum, gold or silver; or
	(d) an option to acquire or dispose of an option specified in (a), (b) or (c);
<i>OTC</i>	means over the counter, i.e. in relation to any <i>investment</i> , an <i>investment</i> which is not traded or listed <i>on exchange</i> or an <i>approved exchange</i> ;
<i>out of the money</i>	means those <i>options</i> and <i>warrants</i> which are not <i>in the money</i> ;
<i>pari passu security</i>	means a <i>security</i> which is the same as another <i>security</i> , except only in respect of payment, entitlement to initial dividend and the nature of <i>documents of title</i> ;
<i>passport institution</i>	means an <i>incoming EEA firm</i> ;
<i>perfectly matching contracts</i>	mean certain <i>OTC derivatives</i> contracts which are included in a legally binding netting agreement that are equal and exact opposites and perfectly matching in all material respects;
<i>permission</i>	permission to carry on <i>regulated activities</i> ; that is, any of the following: <ul style="list-style-type: none"> (a) a <i>Part IV permission</i>; (b) the permission that an <i>incoming EEA firm</i> has, under paragraph 15(1) of Schedule 3 to the <i>Act</i> (EEA Passport Rights), on qualifying for <i>authorisation</i> under paragraph 12 of that Schedule; (c) the permission that an <i>incoming Treaty firm</i> has, under paragraph 4(1) of Schedule 4 to the <i>Act</i> (Treaty Rights), on qualifying for <i>authorisation</i> under paragraph 2 of that Schedule; (d) the permission that a <i>UCITS qualifier</i> has, under paragraph 2(1) of Schedule 5 to the <i>Act</i> (Persons concerned in Collective Investment Schemes); (e) the permission that an <i>ICVC</i> has, under paragraph 2(2) of Schedule 5 to the <i>Act</i> (Persons concerned in Collective Investment Schemes); (f) the permission that the <i>Society of Lloyd's</i> has, under section 315(2) of the <i>Act</i> (The Society: authorisation and permission), which is to be treated as a <i>Part IV permission</i> for the purposes of Part IV of the <i>Act</i> (Permission to carry on regulated activities) in accordance with section 315(3) of the <i>Act</i>;
<i>physical commodities</i>	means the method of calculating <i>PRR</i> under rules 3-166 to 3-

<i>method</i>	169B;
<i>physical commodity</i>	means the actual commodity, <i>documents of title</i> to actual commodities or shipping documents conveying title to actual commodities;
<i>PRA</i>	means percentage risk addition, i.e. a percentage to be applied to the value of positions in investments held by the firm to determine its <i>PRR</i> ;
<i>preference security</i>	means a <i>share</i> with rights, in respect of capital or dividends, superior to those of ordinary equity;
<i>pre-priced deal</i>	means an <i>international offering</i> other than a <i>bought deal</i> all the <i>pricing terms</i> of which have been fixed;
<i>pricing terms</i>	means, in relation to an <i>offering</i> , the amount of currency, maturity, <i>offering price</i> , rate of or means of calculating interest and any prices at which <i>securities</i> may be redeemed or converted or exchanged into other <i>securities</i> ;
<i>primary requirement</i>	is the primary requirement calculated in accordance with Table 3-61;
<i>private customer</i>	means a <i>client</i> who is not a <i>market counterparty</i> or an <i>intermediate customer</i> , including: <ul style="list-style-type: none"> (a) an individual who is not a <i>firm</i>; (b) an overseas individual who is not an <i>overseas financial services institution</i>; (c) a <i>regulated collective investment scheme</i>; (d) a <i>client</i> when he is classified as a <i>private customer</i> in accordance with COB 4.1.14R (Client classified as a private customer); but excluding a <i>client</i> , who would otherwise be a <i>private customer</i> , when he is classified as an <i>intermediate customer</i> in accordance with COB 4.1.9R (Expert private customer classified as an intermediate customer);
<i>profit share</i>	means an appropriation of profit before tax on a predetermined basis for the benefit of management or <i>employees</i> ;
<i>property fund</i>	means a scheme dedicated to permitted immovables and property related assets, whether with or without other transferable securities;
<i>PRR</i>	means the position risk requirement of a firm as calculated in accordance with rules 3-80 to 3-169B;
<i>put option</i>	means an <i>option</i> to sell an <i>investment</i> , other instrument, foreign currency or <i>physical commodity</i> at a given price on or before a

given date;

qualifying debt security means a *debt security* which:

- (1) (a) represents or evidences indebtedness;
- (b) is a *marketable investment*;
- (c) if it or “equivalent debt” is rated by a “relevant agency” (and there has been no announcement that the rating will be cancelled) -
 - (i) the *security* or the “equivalent debt” is so rated at or higher than the level indicated in the table in **Appendix 34**;
 - (ii) there has been no announcement that the rating will be down-graded below the level so indicated; and
 - (iii) the *firm* has no reasonable cause to believe that another “relevant agency” has rated the security or “equivalent debt” below the level so indicated; and
- (d) if neither it nor any “equivalent debt” is rated by a “relevant agency” (or there has been an announcement that such a rating will be cancelled), it satisfies one or more of the following -
 - (i) it is issued or guaranteed by or is subject to the full faith and credit of a sovereign government or province or state thereof (or a corporation over 75% owned by such sovereign government, or province or state), which is a member of the *OECD* and the government, province, state or corporation has not defaulted, or entered into any rescheduling or similar arrangement, or announced the intention of so doing, in respect of itself or its agency’s debt within the last five years;
 - (ii) it is issued or guaranteed by a *supranational organisation*;
 - (iii) it is issued or guaranteed by a corporation (not being a bank, for which see (iv) below) the ordinary *shares* of which are included within the following categories -
 - (aa) UK : constituents of the FT All Share Index;
 - (bb) Japan : constituents of the First Section

of the Tokyo Stock Exchange;

(cc) USA: constituents of the NYSE, AMEX or NASDAQ NMS; or

(dd) countries listed below: the constituents of the FT-Actuaries World Indices in respect thereof;

Australia

Belgium

Canada

Denmark

France

Germany

Hong Kong

Italy

Netherlands

Norway

Singapore

Spain

Sweden

Switzerland

(iv) it is issued or guaranteed by a bank which is supervised by an authority in a state such as is referred to above and has capital and reserves (including subordinated loans which are not repayable within five years) of not less than £100,000,000 or the equivalent as shown by its latest published audited consolidated accounts (or, in the absence of consolidated accounts, unconsolidated accounts); or

(v) is it issued or guaranteed by a local authority or building society in the United Kingdom;

provided that the issuer or guarantor of the *security* is not in default as to any payment on any other *security* issued or guaranteed by it; and

(2) for the purposes of (1) above -

(a) in respect of any *security* of, or guaranteed by, any issuer or guarantor, "equivalent debt" means any

debt which ranks *pari passu* with, or subordinate to, the *security* or (as the case may be) the guarantee; and

- (b) in relation to any issuer or guarantor, a “relevant agency” means one of the agencies named in **Appendix 34** by reference to the category of issuer or guarantor;

qualifying deposit

means a deposit which is one of the following -

- (a) balance on current account with an *approved bank*;
- (b) money on deposit with an *approved bank*, United Kingdom local authority, member of the Finance Houses Association, *stock exchange moneybroker*, *regulated clearing firm*, the National Savings Bank, *exchange*, *approved exchange* or *approved depository* which may be withdrawn within three months;
- (c) money on deposit with an *approved bank* directly related to a transaction creating an offsetting liability for the *firm* or subject to an agreement with the bank allowing its use as collateral for a loan that may be withdrawn within three months, which relates to a liability of the same maturity and arises out of a transaction;
- (d) amount evidenced by a certificate of tax deposit;
- (e) amount evidenced by a *certificate of deposit* issued by a *regulated banking institution* which matures within three months; or
- (f) deposit of cash by way of margin with an *exchange*, *approved exchange*, *clearing house* or *intermediate broker*;

recognised investment exchange

means an investment exchange which is declared by a *recognition order* for the time being in force to be a *recognised investment exchange* (see the list published on the FSA website at: www.fsa.gov.uk/register-res/html/prof_exchanges_fram.html.);

recognised scheme

means a *collective investment scheme* recognised under Chapter V of Part XVII of the Act;

Regulated Activities Order

means the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (SI 2001/544);

regulated banking institution

means any banking institution which has paid up share capital and reserves of over £5,000,000 as shown by its latest published audited accounts, and which is authorised by the FSA or supervised by the central bank or other regulatory authority of a member state of the *OECD* in which the bank is incorporated;

<i>regulated business</i>	means <i>investment business</i> which is <ul style="list-style-type: none"> (a) business carried on from a permanent place of business maintained by a <i>firm</i> (or its <i>appointed representative</i>) in the United Kingdom; and (b) other business carried on with or for <i>customers</i> in the United Kingdom, unless that business is - <ul style="list-style-type: none"> (i) business carried on from an office of a <i>firm</i> outside the United Kingdom which, if that office were a separate person, would fall within the overseas persons exclusions set out in article 72 of the Regulated Activities Order; or (ii) business of an <i>appointed representative</i> of the <i>firm</i> which is not carried on in the United Kingdom;
<i>regulated clearing firm</i>	means a <i>clearing firm</i> which is an <i>authorised person</i> ;
<i>regulated collective investment scheme</i>	means an <i>authorised unit trust scheme</i> , including an <i>ICVC</i> , or a <i>recognised scheme</i> ;
<i>regulated financial institution</i>	means a <i>firm</i> , or an institution which is authorised to conduct <i>investment business</i> involving the execution of transactions on <i>exchanges</i> or on <i>securities</i> or <i>derivatives exchanges</i> by one or more of the following regulators - <ul style="list-style-type: none"> (a) any regulator of <i>investment business</i> in any member state of the European Community (other than the United Kingdom) established by law in that state; or (b) a body referred to in Part 1 of Appendix 35; provided, in the case of any such institution that the <i>firm</i> has no reason to suppose that the institution is in breach, in any material respect, of the rules enforceable by the relevant regulator;
<i>relevant annual expenditure</i>	means the relevant annual expenditure of a <i>firm</i> calculated in accordance with rule 3-73;
<i>reporting accountant</i>	means an accountant appointed: <ul style="list-style-type: none"> (a) by the <i>FSA</i>; or (b) by a <i>firm</i>, having been nominated or approved by the <i>FSA</i> under section 166 of the <i>Act</i> (Reports by skilled persons); to report on one or more aspects of the financial position of the

	<i>firm</i> , including <i>internal controls</i> and reporting returns;
<i>reporting statement</i>	means any one or more of the following types of report as required by the <i>Supervision manual</i> : <ul style="list-style-type: none"> (a) audited <i>annual financial statements</i>; (b) <i>annual reporting statement</i>; (c) <i>auditor's report</i>; (d) internal control letter; (e) quarterly reporting statement; (f) position risk reporting statement; (g) counterparty risk reporting statement; (h) annual reconciliation; (i) monthly reporting statement; and (j) the audited accounts of a <i>subsidiary</i> of the <i>firm</i>;
<i>repurchase agreement</i>	(and <i>sale and buy back agreement</i>) means an agreement for the sale of <i>securities</i> or <i>physical commodities</i> subject to a commitment to repurchase from the same person the same or similar <i>securities</i> or <i>physical commodities</i> ;
<i>requirement</i>	means a requirement included in a <i>firm's Part IV permission</i> under section 43 of the <i>Act</i> (Imposition of requirements), section 45(4) of the <i>Act</i> (Variation etc on the Authority's own initiative) or section 46 of the <i>Act</i> (Variation of permission on acquisition of <i>control</i>);
<i>reverse repurchase agreement</i>	(and " <i>buy and sale back agreement</i> ") means an agreement for the purchase of <i>securities</i> or <i>physical commodities</i> subject to a commitment to resell to the same person the same or similar <i>securities</i> or <i>physical commodities</i> ;
<i>sale</i>	includes any disposal for valuable consideration;
<i>sale and buy back agreement</i>	see <i>repurchase agreement</i> ;
<i>scheme management activity</i>	means the management by an <i>operator</i> of a <i>collective investment scheme</i> of the property held for or within a <i>collective investment scheme</i> of which it is the <i>operator</i> and includes the management of the property of an <i>open-ended investment company</i> by the company itself as its <i>operator</i> but excludes the management of an <i>open-ended investment company</i> by another person as its <i>operator</i> (and excludes in all cases activities relating to transactions in units, <i>shares</i> or interests in the <i>collective investment scheme</i>);

securities and futures firm

means a *firm* whose *permitted activities* include *designated investment business*, which is not an *authorised professional firm*, *bank*, *building society*, *credit union*, *friendly society*, *ICVC*, *insurer*, *media firm*, *service company*, *incoming EEA firm* (without a *top-up permission*), *incoming Treaty firm* (without a *top-up permission*) or *UCITS qualifier*, whose *permission* does not include a *requirement* that it comply with *IPRU(INV) 5* (Investment management firms) or *13* (Personal investment firms), and which is within (a), (b), (c) or (d):

- (a) a *firm* (other than one falling within (d)):
 - (i) which was a member of *SFA* immediately before *commencement*; and
 - (ii) which was not, immediately before *commencement*, subject to the financial supervision requirements of the *FSA* (under section 43 of the Financial Services Act 1986), *PIA* or *IMRO* under lead regulation arrangements;
- (b) a *firm* whose *permission* includes a *requirement* that it comply with *IPRU(INV) 3* or *10* (Securities and futures firms);
- (c) a *firm*:
 - (i) which was given a *Part IV permission* after *commencement*, or which was authorised under section 25 of the Financial Services Act 1986 immediately before *commencement* and not a member of *IMRO*, *PIA* or *SFA*; and
 - (ii) for whom the most substantial part of its gross income, including *commissions*, from the *regulated activities* included in its *Part IV permission* is derived from one or more of the following activities (based, for a *firm* given a *Part IV permission* after *commencement*, on the business plan submitted as part of the *firm's* application or, for a *firm* authorised under section 25 of the Financial Services Act 1986, on the *firm's* financial year preceding its *authorisation* under the Act):
 - (A) an activity carried on as a member of an exchange;
 - (B) making a market in *securities* or *derivatives*;
 - (C) *corporate finance business*;
 - (D) *dealing*, or *arranging (bringing about) deals in investments*, in *securities* or *derivatives*;
 - (E) the provision of clearing services as a *clearing*

	<p><i>firm</i>;</p> <p>(F) <i>managing investments</i>, where those <i>investments</i> are primarily <i>derivatives</i>; and</p> <p>(G) activities relating to <i>spread bets</i>;</p> <p>(d) a <i>firm</i> that is:</p> <p>(i) an <i>ex-section 43 firm</i> which was not authorised under the Financial Services Act 1986 immediately before <i>commencement</i>; or</p> <p>(ii) an <i>ex-section 43 lead regulated firm</i>;</p>
<i>security</i>	<p>means, as defined in article 3(1) of the Regulated Activities Order, any of the following investments specified in that Order:</p> <p>(a) shares (article 76);</p> <p>(b) debentures (that is, instruments creating or acknowledging indebtedness) (article 77);</p> <p>(c) government and public securities (article 78);</p> <p>(d) warrants (that is, instruments giving entitlement to investments) (article 79);</p> <p>(e) certificates representing certain securities (article 80);</p> <p>(f) units (article 81); and</p> <p>(g) stakeholder pension scheme (article 82); and</p> <p>(h) rights to or interests in investments in (a) to (g) (article 89);</p>
<i>settlement day</i>	<p>means the day on which under the recognised practice of an <i>exchange</i> or <i>approved exchange</i>, bargains are contracted for settlement; and in the case of bargains not transacted on an <i>exchange</i> or <i>approved exchange</i>, or entered into for forward settlement, 20 days from the date of the transaction, or, if earlier, the contractual due date;</p>
<i>share</i>	<p>means the investment, specified in article 76 of the Regulated Activities Order (Shares etc), which is, in summary: a share or stock in the share capital of:</p> <p>(a) any <i>body corporate</i> (wherever incorporated);</p> <p>(b) any unincorporated body constituted under the law of a country or territory outside the United Kingdom;</p>
<i>sole trader</i>	<p>means a <i>firm</i> which is not a <i>body corporate</i> and not a <i>partnership</i>;</p>
<i>stock exchange moneybroker</i>	<p>is a <i>moneybroker</i> which is an <i>authorised person</i> and acts as an intermediary in the gilt market;</p>

<i>subsidiary</i>	has the meaning given to it in section 736 of the Companies Act 1985;
<i>supervisory authority</i>	in relation to another member state, means an authority in that state which has regulatory functions in relation to one or more listed activities, <i>core investment services</i> or <i>non-core investment services</i> ;
<i>supranational organisation</i>	means any organisation referred to in Part 2 of Appendix 35 ;
<i>swap</i>	means a transaction in which two <i>counterparties</i> agree to exchange streams of payments over time according to a predetermined basis;
<i>Takeover Code</i>	means the City Code on Takeovers and Mergers and the Rules Governing Substantial Acquisitions of Shares published by the Takeover Panel;
<i>takeover or related operation</i>	means: <ul style="list-style-type: none"> (a) any offer to which the <i>Takeover Code</i> applies and any transaction or arrangement which is of such a nature that the <i>Takeover Code</i> would have applied to it had it concerned a company whose shares are listed under Part VI of the <i>Act</i> and whose head office and place of central management are in the United Kingdom; (b) any offer, transaction or arrangement relating to the purchase of <i>securities</i> with a view to establishing or increasing a strategic holding of a person, or of a person together with his <i>associates</i> in the <i>securities</i> concerned; (c) any transaction or arrangement entered into in contemplation or furtherance of any offer, transaction or arrangement falling within (a) or (b) above; and (d) any transaction or arrangement entered into by way of defence or protection against any offer, transaction or arrangement falling within (a), (b) or (c) above which has taken place or which is contemplated;
<i>Takeover Panel</i>	means the Panel on Takeovers and Mergers;
<i>tangible net worth</i>	is the tangible net worth of a <i>firm</i> calculated in accordance with rule 3-62;
<i>tender offer</i>	means an unconditional offer as a principal to buy <i>securities</i> ;
<i>total PRR</i>	means the sum of all the amounts calculated as a <i>PRR</i> under rules 3-80 to 3-169B;
<i>traditional option</i>	means any <i>option</i> arranged but not traded under the rules of the London Stock Exchange;

<i>trust beneficiary</i>	means a beneficiary under a trust (not being the settlor) who benefits from the performance by a <i>firm</i> as trustee of <i>investment services</i> relating to the management of the trust assets;
<i>underwriting</i>	means a commitment to take up <i>securities</i> where others do not acquire or retain them;
<i>underwriting price</i>	means the price at which the <i>firm</i> is committed to take up the securities or the price at which it is committed to do so if required under the <i>underwriting</i> commitment less any commissions or discounts paid or allowed in connection with the transaction, except to the extent that the <i>firm</i> has taken credit for them in its accounts;
<i>unregulated collective investment scheme</i>	means a <i>collective investment scheme</i> which is not a <i>regulated collective investment scheme</i> ;
<i>variable rate note</i>	means a debt <i>security</i> with the characteristics of an <i>FRN</i> except that the margin with respect to the index rate of interest is subject to variation depending on periodic negotiations;
<i>variation margin requirement</i>	means in relation to a <i>counterparty</i> the value of any amounts which the <i>firm</i> or <i>intermediate broker</i> would be required to pay under the rules of an <i>exchange</i> , <i>approved exchange</i> or <i>clearing house</i> to meet any <i>marked to market</i> losses occurring on contracts undertaken for that <i>counterparty</i> at that time on the assumption that those transactions were the only transactions undertaken on the <i>exchange</i> , <i>approved exchange</i> or <i>clearing house</i> by the <i>firm</i> or <i>intermediate broker</i> at that time;
<i>venture capital business</i>	means the business of: <ul style="list-style-type: none"> (a) investing in, advising on, managing or arranging transactions in <i>venture capital investments</i>; or (b) advising, managing or operating portfolios or <i>collective investment schemes</i> which (apart from funds awaiting investment) invest only in <i>venture capital investments</i>; (c) any <i>custody</i> activities provided in connection with the activities in (a) and (b); or (d) any related ancillary activities;
<i>venture capital firm</i>	means a <i>firm</i> whose <i>permission</i> includes a <i>requirement</i> that it must not conduct <i>investment business</i> other than <i>venture capital business</i> ;
<i>venture capital investment</i>	means an <i>investment</i> which, at the time the investment is made, is: <ul style="list-style-type: none"> (a) in a new or developing company or venture; or (b) in a management buy-out or buy-in; or

- (c) made as a means of financing the investee company or venture and accompanied by a right of consultation, or rights to information, or board representation, or management rights; or
- (d) acquired with a view to, or in order to facilitate, a transaction falling within (a) to (c);

<i>venture capital schemes</i>	means a scheme for providing capital to a <i>body corporate</i> whose equity is not traded or listed on an <i>exchange</i> ;
<i>walkaway clause</i>	means a provision which permits a non-defaulting counterparty to make only limited payments, or no payment at all, to the estate of the defaulter, even if the defaulter is a net creditor;
<i>warrant</i>	means the investment specified in article 79 of the Regulated Activities Order (Instruments giving entitlement to investments), which is, in summary: a warrant or other instrument entitling the holder to subscribe for a share, debenture or government and public security;
<i>warrant fund</i>	means a scheme which is dedicated to <i>transferable securities</i> except that it is permitted to invest entirely in <i>warrants</i> ;
<i>zone A</i>	see definition of <i>Zone A country</i> in the <i>Glossary</i> ; and
<i>zone B</i>	means any country not in <i>Zone A</i> ;

Appendix 20

GUIDANCE NOTES ON RECONCILIATION OF FIRM'S BALANCES WITH A COUNTERPARTY WHICH IS A MEMBER OF AN EXCHANGE

(rule 3-11(1)(d))

Introduction

- 1 The purpose of this guidance is to state how under rule 3-11(1)(d) the reconciliation process with counterparties which are also members of exchanges should be performed.

Scope

- 2 The reconciliation to be performed with counterparties should cover all outstanding balances and *securities* positions with such counterparties from all sources except to the extent that the components of such balances and *securities* positions have been agreed by other means. Agreement by other means shall include (but is not to be limited to) those which have been—
 - (a) matched or cleared through an exchange, clearing house or clearing system; or
 - (b) verified by dispatch to or receipt from the counterparty of a confirmation or statement. Such verification should have been evidenced in writing or by electronic media.
- 3 The reconciliation should cover all remaining outstanding items including, for example, fee-based items, dividends where these are on the *firm's* balance sheet, coupons, amounts arising under *OTC* contracts, *repurchase* and *reverse repurchase agreements* and *securities* lending and borrowing.
- 4 The items to be included should be all those past trade date which is consistent with *trade date accounting*.
- 5 Where necessary a *firm* should initially circularise a list of all relevant open items as set out above rather than a net balance. A *firm* should identify the assumptions made by them in ascertaining which balances (or types of balances) have been included in the reconciliation. A *firm* should also identify where the balances or *securities* positions with a counterparty arise from different accounts operated by them with that counterparty.
- 6 The scope of the rule is intended to cover nil balances although these may be covered on a sample basis only. They are included because discrepancies in such balances may only come to light as being incorrectly stated on the performance of a circularisation. However, reconciliations of nil balances do not need to be performed where—
 - (a) the counterparty is also a *firm*; or

- (b) there has been no outstanding balance with the counterparty at any point during the year.

Timing

- 7 It is considered preferable for a *firm* to be aware in advance at which periods of the year they will receive reconciliations requests. This may be of use to a *firm* in enabling it to plan in advance the allocation of staff for the performance of the reconciliations. Thus, it is suggested that a *firm* submits such circularisations, where possible, at calendar quarter end dates. It is considered that, in any case, the majority of *firms* would be likely to circularise such statements at these dates. However, a *firm* will be eligible to circularise at other dates as, for example, when its own *annual* or *quarterly accounting reference dates* do not coincide with the calendar quarter end.
- 8 A *firm* may perform the reconciliation in conjunction with the work undertaken by its auditors for the purposes of the annual audit.

The obligation on firms

- 9 Where a *firm* receives a statement from a counterparty during the year, the recipient *firm* is not also required by virtue of rule 3-11(1)(d) to send a further statement to that counterparty in the same year.
- 10 A recipient of a circularisation request from another *firm* must use its best endeavours to respond. Notwithstanding paragraphs 7 and 8 above, this obligation will apply even if this request is received more frequently than once a year from the same counterparty or is wider in scope than required by paragraphs 2 to 6 above (for example, by also covering balances which have already been agreed by other means). Rule 3-11 only requires that specific balances be covered. This is intended as a minimum requirement and not necessarily as the norm. If a *firm* need not reply to a request more than once a year or which covered balances of a wider scope, *firms* would be discouraged from requesting such reconciliations.
- 11 Rule 3-11(3) requires a *firm* to respond, within one month of receipt, to a circularisation request received from another *firm*. The one month response period should also be observed in relation to circularisation requests received under rule 3-11(1)(d).
- 12 It is not considered necessary to issue detailed guidance for the procedure to be adopted in cases where the recipient does not reply to a circularisation request sent by a *firm*. It is intended that a *firm* need only take reasonable steps to obtain any such reply. However, before a *firm* has taken such steps, it should not assume that the circularisation is agreed merely due to the absence of a reply from the counterparts.

Appendix 21

GUIDANCE NOTES ON THE VALUATION OF POSITIONS

(rule 3-41(9))

Introduction

- 1 Rule 3-41(9) states that a position must be valued at its close out price, where close out price means that a long position should be valued at current bid price and a short position at current offer price. In addition, rule 3-41(9) states that a *firm* must value a position on a prudent and consistent basis, and have regard to the liquidity of the instrument concerned and any special factors that may adversely affect the closure of the position.
- 2 The following paragraphs give general indications to *firms* on the appropriate valuation methodology. However, it is emphasised that prudence should be the overriding influence in the valuation exercise and that, where uncertainty exists as to the most appropriate price, the *firm* should use that price which gives the most conservative valuation.

General principles

- 3 *Firms* should value positions by reference to market prices, but where necessary should add a prudent and appropriate buffer to the bid or offer price to account for factors which would adversely affect the *firm's* ability to realise the close-out value, such as -
 - (a) the liquidity of the *security* in question;
 - (b) the size of the position held in that *security* relative to the sizes at which prices are quoted;
 - (c) the direction of the position (long or short) relative to the current direction of the market;
 - (d) the exposure of the *firm* to the relevant market as a whole;
 - (e) any conversion or foreign exchange costs that would be incurred if the position were closed out;
 - (f) any other factors which may affect the close-out price.
- 4 Where a mid-market or single price only is available for the *security* in question, *firms* must adjust this price by a prudent and appropriate buffer as outlined in paragraph 3 above.
- 5 With respect to paragraphs 3 and 4 above, *firms* should be able to demonstrate at all times how they determined the final price applied to any position in a *security*.

Appendix 26 (rules 3-81 to 3-165)
SUMMARY TABLES OF WHICH METHOD OF PRR TO APPLY TO AN INSTRUMENT

INSTRUMENT		CIRCUMSTANCES	METHOD	RULES
1	<i>note issuance facilities</i>	all circumstances	<i>note issuance facilities</i>	3-80
2	foreign currency asset or capital or liability	all circumstances	<i>foreign currency exposures</i>	3-150 to 3-154
3	<i>currency option and future</i>	see rule 3-152	<i>foreign currency exposures or foreign currency derivatives</i>	3-150 to 3-154
4	<i>physical commodity, actual and forward</i>	all circumstances	commodities	3-166 to 3-169B
5	<i>physical commodity, option and future</i>	all circumstances	commodities	3-166 to 3-169B
6	concentrated position	all circumstances	method relevant to position + <i>concentrated position</i>	As above
7	forward	equity	<i>equity</i>	3-80
		foreign currency	<i>foreign currency exposures</i>	3-150 to 3-154
		<i>physical commodities</i>	commodities	3-166 to 3-169B
8	<i>regulated collective investment scheme</i>	all circumstances	<i>equity derivatives</i>	3-80
9	<i>non marketable investments and others</i>	all circumstances	100% PRR	3-80

Appendix 33 (exchanges)

LIST OF APPROVED EXCHANGES

The following exchanges are approved for the purposes of the definition of “approved exchange” –

Athens Stock Exchange (ASE)

Barcelona Stock Exchange (Bolsa de Valores de Barcelona)

Belgian Futures & Options Exchange (BELFOX)

Berlin Stock Exchange (Berliner Börse)

Bilbao Stock Exchange (Bolsa de Valores de Bilbao)

BVLP (Bolsa de Valori de Lisboa e Porto)

Bolsa de Mercadorios & Futures (BM&F)

Boston Stock Exchange

Bovespa (The São Paulo Stock Exchange)

Bremen Stock Exchange (Bremer Wertpapierbörse)

BVRJ (The Rio de Janeiro Stock Exchange)

Cincinnati Stock Exchange

Copenhagen Stock Exchange (Kobenhavns Fondsbors)

Dusseldorf Stock Exchange (Rheinisch-Westfälische Börse zu Düsseldorf)

Frankfurt Stock Exchange (Frankfurter Wertpapierbörse)

Hannover (Niedersächsische Börse zu Hannover)

Italian Exchange

Kuala Lumpur Stock Exchange

Luxembourg Stock Exchange (Société de la Bourse de Luxembourg SA)

Madrid Stock Exchange (Bolsa de Valores de Madrid)

Mercato Italiano Futures (MIF)

Munich Stock Exchange (Bayerische Börse in München)

Nagoya Stock Exchange

New Zealand Stock Exchange

Oslo Stock Exchange (Oslo Bors)

Stuttgart Stock Exchange (Baden-Württembergische Wertpapierbörse zu Stuttgart)

Swiss Exchange (SWX)

Taiwan Stock Exchange

Tel Aviv Stock Exchange

The Stock Exchange of Thailand

Valencia Stock Exchange (Bolsa de Valores de Valencia)

**Appendix 34 (“qualifying debt security”)
RELEVANT AGENCY**

The agencies in the table below are “relevant agencies” for the purposes of the definitions of “qualifying debt security”.

		Securities minimum category	Money market obligations minimum category
1	For all issuers Moody’s Investors Service Standard and Poor’s Corporation Fitch Ratings Ltd	Baa3 BBB- BBB-	P3 A3 A3
2	For all banks, Building Societies and parent companies and subsidiaries of banks Thomson BankWatch	BBB-	TBW-3
3	For Canadian issuers and issues in Canadian dollars Canadian Bond Rating Service Dominion Bond Rating Service	B++low BBB low	A-3 R-2
4	For Japanese issuers and issues in Japanese yen Fitch Ratings Ltd Japan Credit Rating Agency, Ltd Japan Rating and Investment Information, Inc Mikuni & Co Ltd	BBB- BBB- BBB- BBB	F-3 J-2 a-2 M-3
5	For United States issuers and issues in US dollars Fitch Ratings Ltd	BBB-	F-3

Appendix 35 (“regulated financial institution” and “supranational organisation”)

LIST OF REGULATED FINANCIAL INSTITUTIONS AND SUPRANATIONAL ORGANISATIONS

PART 1

List Of Regulators For The Purposes Of The Definition Of Regulated Financial Institution

Australian Stock Exchange Limited;
The Hong Kong Monetary Authority;
The Hong Kong Securities and Futures Commission;
Investment Dealers Association of Canada;
Japanese Ministry of Finance;
Sydney Futures Exchange;
Toronto Stock Exchange;
United States Commodity and Futures Trading Commission;
United States Securities and Exchange Commission;
Vancouver Stock Exchange.

PART 2

List Of Supranational Organisations

a multilateral development bank;
The Bank for International Settlements;
The Council of Europe;
Euratom (The European Atomic Energy Community);
Eurofin (The European Company for Financing of Railroad Rolling Stock);
The European Coal and Steel Community;
The European Economic Community;
The International Monetary Fund;

Appendix 37 (rule 3-177) GUIDANCE NOTES FOR MONEY BROKERS

Application Of The Counterparty Risk Requirement

Introduction

- 1 This Appendix offers guidance to *money brokers* on the application of rule 3-177 relating to the counterparty risk requirement.

Calculation of 0.5% additional CRR

- 2 A *money broker* should calculate the additional CRR requirement as follows -
- (a) if a *money broker* is satisfied that it has a legal right to net off exposures with an individual *counterparty*, valid and enforceable in the United Kingdom or any other relevant country, it may do so in accordance with the rule 3-176(3). The obligation rests with the broker to demonstrate that the method it uses is reasonable and justifiable. It is stressed that this right to net is at the option of the *firm* and is not mandatory;
 - (b) a *money broker* should then aggregate its total level of *securities* subject to a *repurchase or reverse repurchase agreement*, *securities* lending or borrowing agreement and *sale and buy back or buy and sale back agreement* (either net or gross) to or from individual *counterparties* outside an *approved payments system* and money lent against *Talisman short-term certificates*. A capital requirement of 0.5% of this sum should then be calculated.

Approved payments systems

- 3 The following are *approved payment systems* when the systems concerned provide for settlement on a delivery versus payment basis -
- Austraclear New Zealand
 - Banca D'Italia's Giornaliera
 - Banque Nationale de Belgique
 - Bank of Spain Interbank Bond Settlements System
 - Banque de France's SATURNE
 - BOJ-NET DVP
 - Central Gilts Office
 - Clearstream
 - Depository Trust Company
 - Euroclear
 - Fedwire - see The Federal Reserve System
 - Kassenverein
 - Necigef
 - SICOVAM (Relit settlement only)

- Sociedad de Compensacion y Liquidacion de Valores
- The Canadian Depository for Securities Ltd
- The Federal Reserve System (Fedwire), and
- Vardepapperscentralen VPC AB

Collateral

- 4** It is recognised that letters of credit may be used as collateral and may have a value in excess of the amount of the *securities* transferred. Provided it is clearly established that claims cannot be made on the letter of credit in excess of the value of the *securities* borrowed, no *CRR* will be imposed on the amount by which the letter of credit exceeds the value of the *securities* borrowed. *Firms* are reminded that the definition of *acceptable collateral* includes *marketable investments* which may take the form of money market instruments.

Appendix 43
GUIDANCE NOTES ON THE FINANCIAL RESOURCES AND ACCOUNTING
TREATMENT OF SOFT COMMISSION AGREEMENTS

(rules 3-73 and 3-182(3))

1 Introduction

This Appendix contains detailed guidance to the following rules–

Rules	
3-73	Expenditure requirement
3-182(3)	<i>CRR</i> requirement on other amounts owed to a <i>firm</i> arising out of <i>investment business</i> or <i>investment dealing activity</i>

2 The *FSA* is of the view that it is not responsible for setting accounting policies in relation to a *firm's annual financial statements*. However, the *FSA* considers that it is preferable for all *firms* participating in "soft commission agreements" to have consistent accounting policies. Without such consistency, certain *firms* would have a competitive advantage in terms of their *financial resources*. Therefore, for the purposes of completing *financial reporting statement* submitted to the *FSA*, appropriate accounting policies should be used. The guidance and interpretations made in this Appendix should be considered in this context.

3 The guidance applies to all *firms* which participate in "soft commission agreements" whether or not this is the sole *investment business* of the *firm*.

4 Definition

A soft commission agreement means–

"any agreement, whether oral or written, under which a *firm* which deals in *securities* on an advisory basis, or in the exercise of discretion, receives goods or services in return for an assurance that not less than a certain amount of such business will be put through or in the way of another person;"

5 Description

A "soft commission agreement" is understood as being one in which a fund manager agrees, either formally or informally, to provide a broker with a certain amount of commission in any one period in return for the provision of services "free". Those services may be provided in-house or by third parties and may take the form of specific research provided by analysts, portfolio valuation systems, or information packages, plus the associated computer hardware and software.

- 6 Under traditional broking arrangements, the full service broker normally receives commission in return for the total servicing of a fund manager's account, a package which includes execution, perhaps custodianship and, almost certainly, research, also "free". The services provided under traditional broking arrangements are in-house i.e. within a broking group, and mostly are not conditional upon receipt by the broker of a certain level of commission, although there is usually an understanding which may never be articulated, that a certain volume of business will be generated.

7 Existing difference in accounting policies

The accounting policies used can in general be divided into those which are "profit & loss" based and those which are "balance sheet" based. Under the former, the *firm* will write-off such expenditure to its profit & loss account but will usually not accrue a liability in its *financial reporting statements* for commissions received in advance. Consequently, the "normal" profit & loss based accounting systems for expenses incurred and commissions received will be used. It should be noted that such *firms*, as they are fundamentally participating in traditional broking arrangements, may not have legally enforceable "soft commission agreements" with their counterparties, such that there may be no absolute contractual liability on the *firm* or counterparty to provide expenditure or commission.

- 8 *Firms* using the "balance sheet" approach will accrue for liabilities but will also tend to capitalise their expenditure under "soft commission agreements". This may be the policy used by *firms* which specialise in legally enforceable "soft commission agreements" and reflects the legal status of such agreements. These may contract the counterparty to pay a level of commission related to the level of expenditure incurred by the *firm* (and vice versa if the counterparty has paid advance commission in excess of the expenditure paid by the *firm*).

9 Expenditure and balances receivable

Once expenditure is incurred for a counterparty, the soft commission broker may claim that contractually the counterparty is bound to pay him a certain multiple of that expenditure in the form of commission within a certain period of time from the date the expenditure was incurred. Consequently, certain *firms* have previously capitalised their expenditure and shown it as an asset for the purposes of calculating their *financial resources*.

10 Required treatment

Where a *firm* incurs expenditure on behalf of a counterparty or counterparties in respect of "soft commission agreements" (whether or not it is incurred in relation to a written contract), the *firm* should immediately write off such expenditure to its profit & loss account.

- 11 Notwithstanding the above, expenditure may be capitalised (as an asset) in the balance sheet of the company which incurred the expenditure, **only**

where this amount is recoverable under a legally enforceable contract (see paragraph 18 below). Where such expenditure is capitalised it will be subject to rule 3-182(3).

12 Income and balances payable

Once commission income is received from a counterparty, the *firm* may recognise that contractually it is bound to pay the counterparty a certain proportion of that income, in the form of the counterparty's expenses, within a certain period. Although certain *firms* are including this amount as a liability on their balance sheet (and thus reducing their *financial resources*), other *firms* are making no such provision.

13 Required treatment

Where a *firm* has a contractual liability to, or on behalf of, a counterparty or counterparties which arises from a legally enforceable "soft commission agreement", the *firm* should accrue in its *financial reporting statements* a liability for the relevant proportion of any advanced commission income received from the counterparty that will have to be subsequently incurred as an expense by the *firm* in the form of a payment on behalf of the counterparty for allowable goods and services.

14 Expenditure requirement

Once expenditure is incurred for a counterparty, the soft commission broker may claim that contractually the counterparty is bound to pay him a certain multiple of that expenditure in the form of commission within a certain period and thus such expenditure should not be included in the *firm's* expenditure requirement.

15 Required treatment

Expenditure incurred by soft commission brokers should be included in a *firm's* expenditure requirement, unless it is incurred under a legally enforceable "soft commission agreement" when it may be excluded from the expenditure requirement calculation.

16 The reasoning behind this treatment is that the expenditure of a *firm* participating in soft commission arrangements is similar to shared commissions and can, therefore, be treated as though it were shared commissions under rule 3-73(2)(f), except to the extent that such expenses are irrecoverable, i.e. except where there is no enforceable legal agreement.

17 It is considered that certain *firms* may have been under the misapprehension that there was a concession for all expenditure related to "soft commission agreements" regardless of whether the agreement was legally enforceable. Where a *firm* undertakes a mixture of business between legally enforceable contracts and informal arrangements (all of which the *firm* would classify as

"soft commission agreements"), it must take great care in allocating expenditure between legally enforceable contracts and others. Alternatively, it may decide to include all expenditure in the expenditure requirement regardless of source.

18 Legally enforceable contracts

For the purposes of this guidance, for a "soft commission agreement" to be legally enforceable there should be a specific written legal contract governing the arrangements. The contract should be legally enforceable by the *firm* involved, both in the UK and in any other relevant country.

Appendix 46 (Table 3-173(2)B)

COUNTRIES/TERRITORIES IN WHICH CRR ON ISSUING MARKET FREE DELIVERIES MAY BE RELAXED

Introduction

This Appendix lists the countries/territories in which *free deliveries* made in the issuing market are subject to a reduced *CRR* of 15% of the *free delivery* value, and the time limit on this reduced *CRR*.

Country/Territory	Business days since delivery
Hong Kong SAR	20
Indonesia	30
Malaysia	30
Philippines	75
Singapore	21
Thailand	45

Appendix 56

Guide To Adequate Credit Management Policy (ACMP) (rules 3-173 to 3-175, 3-300 and "ACMP")

Introduction

- 1 This appendix contains general guidance on the standards which the FSA expects a *firm's ACMP* to meet.

Objective

- 2 the FSA's objective is to ensure that adequate procedures and controls are in place to manage effectively the granting of credit and the monitoring and controlling of credit risk.

Scope

- 3 The guidance applies to any *firm* which wishes to take advantage of the lower *CRR* percentages (by which counterparty exposures must be multiplied).
- 4 Before a *firm* may use the lower percentages in calculating *CRR* and in preparing its financial reporting statements, it must meet the requirements set by 3-300. The *ACMP* and its operation will be reviewed periodically by the *FSA* and, where it is no longer operating effectively, the *firm* may be in breach of those requirements.

Background

- 5 The *FSA* is aware that *firms* grant credit to counterparties in many different ways, including for example, loans to cover actual margin calls as a result of delays between trade date and final settlement or of late settlement etc. This guidance is designed to cover all instances where a *firm* becomes exposed to credit risk although, depending on the way in which credit risk arises, the procedures for managing it may differ.
- 6 In considering the credit management policies of a *firm*, the *FSA* will expect the *firm* to operate a robust control structure which is appropriate to the size, scale and nature of its business and the diversity and complexity of its exposures. The *FSA* recognises that different approaches to and styles of credit management can create an effective operational control environment. Therefore, it is not appropriate for the *FSA* to lay down prescriptive standards which it would expect a *firm* to meet, but rather to suggest a broad framework which is flexible, allows for individualised solutions and can accommodate and encourage evolutionary developments.
- 7 The prime components of a sound credit risk management process are:
 - the definition by a *firm* of what constitutes a credit exposure/risk and is therefore covered by the *firm's ACMP*;

- a comprehensive credit risk measurement approach;
- the existence of guidelines and other parameters used to determine credit limits and govern the level and types of risk taken; together with
- a strong management information system for controlling, monitoring and reporting exposures.

Thus, when the *FSA* reviews a *firm's* credit management process, it will seek comfort that credit exposures are managed and controlled in a highly disciplined manner and that the relevant staff are well versed in the *firm's* credit procedures.

- 8 Where a *firm's* credit risk management is controlled or overseen by its parent or an affiliate in the same group, provided that the *firm* can identify reasonable grounds for believing that the level of control is suitable, this should not impede use of the *firm's* *ACMP*.

General principles

- 9 In forming its view as to the adequacy of a *firm's* credit risk management process, the general characteristics which the *FSA* may take into account include the following:

Role of senior management

- (a) whether the framework of credit risk management, i.e. a *firm's* policies and procedures, is overseen by the board of directors or an equivalent management body;

Procedures

- (b) whether there are clearly established lines of responsibility and levels of authority for:
- the granting of credit to a counterparty;
 - extending its permitted use to cover risk arising on a product new to the counterparty;
 - increasing existing credit facilities; and
 - the monitoring and controlling of all credit risk;
- (c) the extent to which the functions of granting, measuring, monitoring and controlling credit risk are managed independently of the front office with a direct reporting line to the senior management ultimately responsible for credit risk management;
- (d) whether good channels of communication exist which ensure that the *firm's* credit management procedures are well understood and followed by all relevant personnel;

- (e) whether procedures exist for identifying unintentional credit exposures and dealing with counterparty which has failed to settle its obligations to the *firm*, (whether merely due to a delay or actual default), or which is expected not to settle its obligations on the due date; including arrangements for closing out transactions. In addition, the *FSA* may consider whether a *firm* has the ability to identify and attempt to predict, as well as quantify, any shortfall as it arises and on an aged basis;
- (f) whether mechanisms exist for a daily comparison of exposures with credit limits, including the production of exception reports, and the procedures to be followed to deal with the results of those exception reports;

Documentation

- (g) whether a *firm's* credit management policies and procedures are properly documented and reviewed by the *firm* on a regular and thorough basis to ensure that they continue to remain appropriate and sound;
- (h) whether records are kept in respect of each counterparty (identified on an individual legal entity basis) indicating in sufficient detail, the level of credit risk to a counterparty to which the *firm* is willing to expose itself. Where a *firm* grants a credit facility similar to a loan to cover, for example, margin calls, such records might give details of the credit facility extended to a counterparty together with any information gathered in support of the decision to grant that credit facility, the types of transaction which the *firm* may enter into with the counterparty and to which the credit facility may be allocated. Credit information relating to counterparties should be regularly updated and reviewed by the *firm* to ensure that any credit facility granted remains appropriate;

Collateral and margin

- (i) whether the *firm* has written policies relating to the margining and collateral arrangements with its counterparties. Terms of business or customer agreements would normally detail the circumstances when margin might be called, and the type and level of collateral which would be acceptable to the *firm* on the basis of its liquidity, volatility and ability to be realised. In addition, it may be relevant to consider the degree to which a *firm's* collateral records are kept up to date and include details of the practical procedures for the realisation of such collateral.

Measurement and monitoring of exposures

- (j) whether a *firm* has mechanisms for identifying the level of concentration of credit risk exposures to each individual counterparty, and each group of connected counterparties, etc on a regular and timely basis;

- (k) where a *firm* uses risk reduction techniques (such as master agreements, netting agreements, collateralisation arrangements or the taking of third party credit enhancements, including letters of credit and guarantees), whether the *firm* has procedures for scrutinising documents and assessing their impact on the credit risk of the *firm* and assessing the quality of any guarantees or letters of credit;
- (l) depending on the nature of the credit exposures to which a *firm* is subject, whether the *firm's* mechanisms for measuring such exposures are appropriate to cover the type or level of risk to which they give rise.

Additional Guidance on the FSA's Assessment of ACMPs

Preamble

This document is intended as a guide to those areas of Credit Management Policies which the *FSA* will address when considering their adequacy.

A definition of credit and the measurement of credit risk

The *FSA* expects that *firms* have a clear definition of what is considered to be “credit risk” (by whatever name it is known) within the *firm*.

The *FSA* expects *firms* to consider in depth the measurement of the extent of Credit Risk which is incurred vis a vis any given counterparty. *Firms* should be aware that the extent of credit risk incurred will not necessarily be the same as the nominal value of contracts entered into (“value at risk” concept).

The *FSA* will expect that *firms* measure and monitor the extent of Credit Risk incurred vis a vis any given counterparty by reference to a system of limits showing the maximum Credit Risk which the *firm* considers it prudent to incur vis a vis that counterparty having regard for the financial strength of the counterparty.

The *FSA* expects there to be adequate procedures within the *firm* for the recognition of where credit risk may be incurred, for the approval of incurring such risk, and, once incurred, for the monitoring of that risk to ensure the satisfactory recovery of all amounts owed to the *firm* by a counterparty.

The decision to grant credit

If there is a formal decision making body (e.g. a “Credit Committee”) which reviews applications for credit:

- How does it derive its authority?
- What is the extent of any Credit Committee’s authority as regards:
 - amount of credit granted
 - tenor of credit granted
 - products for which credit lines may be approved
 - industry sectors for which credit lines may be approved?
- How is any Credit Committee constituted?
- What are the qualifications of any Credit Committee’s members to make the decisions required of them?

- Independence of Committee from profit centres
- Recording of Approvals

If there is no formal committee, what procedures exist to ensure adequate collective responsibility for credit decisions giving regard for the duality (“four eyes”) principle and independence of decisions made from profit centres likely to benefit from income? e.g.

- “round robin” circulation of papers to Directors/Credit Management
- individual sign off on each transaction/deal

Many of the comments noted above concerning a “Credit Committee” will be relevant also where no formal Committee meets, as will the following remarks concerning the documentation provided to those making credit decisions.

What documentation is provided to those charged with reaching decision to grant credit?

Cover sheet detailing proposed credit.

- Name of proposed counterparty (identify correct legal entity)
- Address of proposed counterparty
- Amount of credit
- Currency of credit
- Tenor of credit
- Collateral/Security proposed (where applicable)
- Remuneration for credit granted
- Products
- Existing exposure to counterparty (in case of increase/review)
- Previous payment performance of counterparty (in case of increase/review)

Financial information on proposed counterparty.

In order to ascertain the financial strengths and weaknesses of a proposed counterparty the FSA expects *firms* to revert to financial information, some examples of which are given below.

- Annual report and accounts
- Analysis of annual reports and accounts

- Credit reference agency reports e.g. Dun and Bradstreet
- Rating agency reports e.g. Standard and Poors, Moody's
- Brokers reports
- Bank status reports
- Statements of net worth

“Credit memorandum” or other internally produced paper outlining the reason for proposing the granting of credit to the counterparty.

Some areas which might be covered by such a memorandum are as follows:

- Background information on relationship with proposed counterparty
- Commentary/analysis of financial information
- Future prospects (for profitability, growth etc.)
- Reason for present proposal
- What benefit will it bring to a *firm's* relationship with company?
- Perceived risks in providing the credit proposed
- What measures have been taken to mitigate these risks?
- Provision of management accounts
- imposition of financial covenants
- Taking of security
- Comments on the collateral or security to be taken
- Comments on legal documentation to be employed
- Industry exposure
- Country exposure
- Spread of counterparties - large exposures

The monitoring of credit exposure

Once a proposal to grant credit has been approved the *FSA* will expect that there are adequate procedures in place to ensure the proper monitoring of all credit exposures entered into.

The *FSA* expects the monitoring function to be separate from and managed independently of those profit centres which may benefit from the incurring of credit risk.

In order to ensure adequate monitoring of credit exposure it will be necessary for firms to ensure that decisions concerning credit matters are communicated promptly and efficiently to those who are responsible for their utilisation and monitoring. firms may wish to consider how such matters are communicated to:

- Those entitled to commit the *firm*
- Credit Control Officers
- Senior Management
- Documentation Staff

The *FSA* will consider the methods by which this information is communicated e.g. memorandum, manual lists, credit procedures manuals etc.

Computer systems

Where use is made of computer systems the *FSA* will consider the various methods by which the integrity of databases is ensured. These could include

- Password protection/access rights
- Accuracy/key verification
- Duality principle
- Physical security of systems
- Back up

Where information is transferred between computer systems e.g. for reporting purposes or to PC based systems the *FSA* will consider any reconciliations which are performed.

Reporting

The *FSA* expects there to be an adequate reporting system for the monitoring of credit exposure. Many *firms* make use of a series of reports, analysing their credit exposure based on a number of different criteria. Examples of the kinds of reports which may be found useful by *firms* are given below.

- Excess reports/Exception reports
- Exposure reports
 - by customer/group/connected customers
 - by industry
 - by country
- Overdue payments reports
- Facilities due for review
- Facilities by collateral/security type
- Collateral/security held
- Large Exposures

The *FSA* will give consideration to the frequency of production of reports used in monitoring credit risk.

Credit Risk Management/Control

The *FSA* will expect to be given details of the action taken where monitoring shows that any aspect of credit exposure is not in line with previously agreed parameters.

For example where exposure is in excess of approved limits the *FSA* will expect to be informed about what action is taken, where payments are not received, how this is followed up. If a counterparty's financial standing deteriorates, what action is taken to attempt to mitigate possible credit loss?

Documentation

The *FSA* expects *firms* to have adequate procedures in place to be certain that all transactions which require documentation are documented and that this occurs within an acceptable time frame, and that any transactions which fail to be documented are identified and reported to Senior Management for appropriate action to be taken.

The FSA expects any staff responsible for documentation to be separate from front office/profit centres and have an independent reporting structure. This will ensure that the commercial wish to trade and do business does not cloud the negotiation of effective and binding legal documentation.

- Suitability of documentation to be used
- Preparation of documentation
- Qualification of staff (or choice of solicitors to be instructed)
- Training of documentation staff
- Tenacity of documentation staff

Basic documentation to be obtained from all counterparties might include

- Certificate of incorporation
- Memorandum and articles of association (M&AA)
- Board Resolution

Other documents which a *firm* may wish to call for prior to entering into transactions would include:

- a statement of officers authorised to act for the counterparty and to commit it to transactions
- a list of authorised signatories where one exists
- an audited annual report or interim figures
- credit reference report or bank status report

Other areas for consideration could include:

- Prompt execution of documentation
- Monitoring response to documents sent out
- Chasing where no response
- Reporting missing documentation to senior management
- Proper execution
- Secure storage of documentation
- Regular review of documentation held

Ongoing review of credit risk

The *FSA* expects firms to have in place adequate procedures for the annual (or more frequent) review of credit risk.

- Scope of the review
- Financial information
- Action where concern is raised
- Possible need for more frequent review
- Monitoring of counterparties' performance
- Defaults and delinquent and bad debts
- Provisioning policy

The *FSA* will expect a *firm* to be able to explain what action may be taken as the result of review e.g. reduction of credit limit, calling for further collateral etc. where the review indicates cause for concern.

Documentation of credit policies and procedures and customer files

The *FSA* will expect *firms* to consider the manner in which their Credit Policies are documented. Areas for comment could include:

- Credit Procedures manuals and the context in which they are used
- Internal Board Minutes showing delegated authority
- Credit Committee Minutes
- Operations manuals
- Training material for staff
- Internal memorandum detailing credit policy
- Customer Credit files, to contain
 - credit analysis information
 - copies of decisions to grant credit
 - copies of relevant documentation
 - press cuttings
 - copies of data input documents

Appendix 62

NETTING

Similar Types of Transactions

The rules set out the requirements to be met by firms before offsetting exposures in 'similar types of transactions' with a counterparty (i.e. being those transactions falling under a particular counterparty risk rule). The netting of exposures within a particular rule is to be applied on a first in first out basis.

Derivative Transactions

Firms may offset the negative replacement cost on written OTC options against the positive replacement cost of OTC purchased options with the same counterparty.

Guidance On The Netting Of Counterparty Exposures

Introduction

1. This appendix contains guidance on the requirements to be attained in order for firms to net counterparty exposures assessed under the following areas.

Subject
Cash against documents transactions
Free deliveries of securities
Repurchase and reverse repurchase, securities lending and borrowing and sale and buy back agreements
Derivative transactions
Other amounts owed to a firm arising out of trading book business

Scope

2. The guidance applies to any firm subject to the CRR rules and which takes advantage of the netting provisions contained therein.

Background

3. Agreements which can effect set-off of counterparty exposures exist in two forms:
 - (a) novation agreements (referred as netting by novation) which replace existing contracts with one new contract and therefore can only be used to cover similar transactions with payments in the same currency for the same value dates; and
 - (b) netting agreements which can be used to cover transactions of very different types.

The guidance below applies to both novation agreements and netting agreements.

Principles of Offset

4. Before offsetting exposures in similar types of transactions with a counterparty a firm must have a contractual netting agreement with that counterparty which:
 - (a) covers the transactions which the firm is seeking to net;
 - (b) creates a single obligation in each currency or a single obligation to pay a net sum of cash in the event of default, bankruptcy, liquidation or similar circumstances;
 - (c) does not include a walkaway clause; and
 - (d) is supported by written and reasoned independent legal opinions to the effect that, in the event of a legal challenge, the relevant courts would find the firm's exposure to be the single net amount mentioned in (b) above.

Statement of Law on Netting

5. The prerequisite of holding a netting agreement supported by an independent legal opinion in order to offset exposures is not required where the Financial Law Panel's (November 1993) Statement of Law on netting applies. This Statement of Law indicates that under English law rule 4-90 of the Insolvency Rules 1986 imposes a requirement for complete set-off of transactions between parties incorporated in England and Wales, provided the transactions are mutual (i.e. credits, debts or claims arise from dealings between the same parties and that the parties are acting in the same capacity). Furthermore, it indicates that set-off is mandatory, applies whether or not there is any contractual entitlement to set-off and cannot be excluded by agreement between the parties.
6. As mentioned above mutuality is required in order for there to be complete set-off of transactions. Accordingly, firms are expected to have procedures in

place to identify the counterparty and the capacity in which the counterparty is acting. Firms proposing to rely on the Statement of Law on netting must satisfy themselves of the appropriateness of such reliance and, where in doubt, obtain legal advice. It is important to note that Insolvency Rule 4.90 does not apply to building societies, statutory organisations generally, mutual societies, partnerships and individuals.

Legal Requirements

7. Legal opinions will be needed for the:
 - law of the jurisdiction in which the counterparty is organised;
 - law of the jurisdiction in which any branch involved is located;
 - law that governs the agreement and, if different, the law that governs individual transactions pursuant to it; and
 - law that governs the legal status of the counterparty who is entering into transactions of the type which the firm is seeking to net.

8. Where a firm uses an industry standard agreement which contains netting/set-off clauses the firm may rely only on a legal opinion relating to the netting/set-off clauses in that standard agreement where no amendment has been made to the agreement which would materially affect these clauses and where the legal opinion addresses the capacity of counterparties of the type with which the firm wishes to contract, the contract type and the relevant jurisdictions.

9. Where a netting agreement provides that one or both parties may enter into transactions with each other under the agreement through any of its (or certain designated) branches, then all such branches included in the agreement will be considered to be located in relevant jurisdictions for the purpose of this guidance.

10. Where a netting agreement involves more than one jurisdiction, a legal opinion is required for each to the effect that the agreement creates a single obligation in each currency or a single obligation to pay a net sum of cash in the event of default, bankruptcy, liquidation or similar circumstances.

11. As mentioned above legal opinions should relate to the law of the jurisdiction in which the counterparty is organised (i.e. incorporated or resident). However, certain circumstances may arise where this requirement could be considered not to be applicable; for example where:
 - a firm has no assets or exposure in that jurisdiction;
 - any judgement obtained in that jurisdiction against a firm would not be enforceable under any of the rules in the UK relating to the enforcement of foreign judgements; or

- there are no other factors relating to that jurisdiction which would affect the ability of a firm to make net payments as contemplated by the netting agreement.
12. Where a firm believes that the law of the jurisdiction in which a counterparty is organised is not relevant, that point must be addressed in the legal opinion supporting the netting agreement. The ability to exclude the law of the jurisdiction in which a counterparty is organised does not extend to the netting of those off balance sheet exposures listed in the Solvency Ratio Directive: the amendment to this directive (to permit netting) specifically requires this matter to be addressed in the legal opinion.
 13. It is recognised that, with certain aspects of the agreement, it may not be possible to obtain a definite opinion or that a positive opinion regarding enforceability of the netting agreement can only be obtained subject to certain assumptions and/or qualifications. Where qualifications are made, they should be specific and their effect adequately explained. In the same way, assumptions should be specific, of a factual nature (except in relation to matters subject to the law of a jurisdiction other than that covered by the opinion) and should be explained in the opinion.
 14. Legal opinions on netting agreements must be obtained from independent legal advisers with sufficient expertise and experience in this area of law. Opinions from in-house counsel will not be acceptable. Where the regulator in the jurisdiction of the counterparty is satisfied that the netting agreement is not enforceable under the laws of that jurisdiction, the netting agreement cannot be relied upon regardless of the opinions obtained by a firm.

Compliance with the Legal Requirements

15. It is the responsibility of firms to ensure that the legal requirements set out above are met (firms are to calculate CRR on the gross value of exposures to counterparties where this is not the case). Firms do not need to apply to the FSA in order to net exposures. Similarly, legal opinions on netting agreements and the agreements themselves are not required to be submitted to the FSA for approval. The FSA will establish the existence of legal opinions and netting agreements when compliance with the above requirements is being monitored by its staff.
16. Firms are expected to put procedures in place to ensure that the legal characteristics of netting arrangements are kept under review in light of possible changes in the relevant law.
17. Firms are expected to maintain records demonstrating that, in relation to the legal requirements, the following considerations have been addressed:
 - the applicability of the netting agreement to the counterparties, jurisdictions and transactions involved;

- the applicability of the opinions to the counterparties, jurisdictions and transactions involved;
 - where more than one jurisdiction is involved, the potential for conflicts in law;
 - all documentation is complete and still valid and that the agreement has been properly executed (i.e. that the acceptance of terms have been evidenced);
 - the nature and effect of any qualifications in the legal opinions and assessment that these do not impair the obligation to pay a net sum of cash in the event of default, bankruptcy, liquidation or similar circumstances; and
 - where an industry standard agreement is used upon which a generic legal opinion has been obtained, identification of those clauses which if altered during the course of negotiating the agreement would affect the right to offset. Internal legal counsel is to evidence review of these agreements to ensure that the effectiveness of the set off clauses has not been altered directly or indirectly by virtue of other clauses being added or deleted.
18. Firms are expected to hold a copy of the legal opinion and the agreement to which it relates.
19. Firms are to net exposures within a particular rule on a FIFO basis. Firms may net only current exposures and cannot net potential future exposures.

Cross-Product Netting

Introduction

The FSA will consider granting rule waivers in order to permit firms to take account of cross-product netting in the calculation of their Counterparty Risk Requirement (CRR) in instances where the FSA regards it appropriate.

The current drafting of the FSA's Financial Rules for securities and futures firms allows 'similar' types of transactions to be netted (where those transactions are covered by a valid netting agreement, with a supporting legal opinion). In practice, 'similar' has been defined as all transactions which fall within a particular CRR Rule treatment. Thus, currently, for the calculation of CRR in relation to exposures to a counterparty which are covered by valid netting arrangements, a firm would be required to assess, for example, a net exposure for all derivative transactions with that counterparty and a separate net exposure for all repo type transactions with that counterparty.

The FSA will consider granting waivers in accordance with SUP 8, though in general it will expect the following conditions to be met:

1. For the types of transaction which the firm is seeking to net, the firm must have the capability to monitor, and must in practice manage, the resultant exposures on a net basis.
2. All transactions which the firm is seeking to net must be covered by valid netting agreements and supported by legal opinions, in accordance with the requirements of the FSA's Financial Rules; and
3. Where underlying netting agreements are linked by a master netting agreement, the legal opinion must address the enforceability of the netting arrangements in their entirety;

One factor that the FSA will consider in assessing whether a particular applicant meets these requirements is whether the firm has had the use of its ACMP sanctioned for the purposes of calculating CRR.

4. Chapter 4: Lloyd's firms

4.1 APPLICATION

- 4.1.1 R This chapter applies to the *Society* and *members' advisers*.
- 4.1.2 R This chapter does not apply to a *members' adviser* which is subject to another chapter of *IPRU(INV)*.
- 4.1.3 D The directions in *IPRU(INV)* 4.4.1D to 4.4.5D and 4.5.1D are given to the *Council* and to the *Society* acting through the *Council*.

4.2 PURPOSE

- 4.2.1 G This chapter identifies the financial resource requirements and requirements as to accounts and statements to be met by certain *firms* conducting business at Lloyd's.
- 4.2.2 G The directions in *IPRU(INV)* 4.4.1D to 4.4.5D and 4.5.1D are given under section 318 of the *Act* (Exercise of powers through Council), for the purpose of achieving the objective specified, as required by section 318(2) of the *Act*, in *IPRU(INV)* 4.3.1D.
- 4.2.3 G *Underwriting agents* are subject to regulation by the *Society* as well as by the *FSA*. In particular, they are subject to requirements as to their financial resources and as to making and maintaining accounting records, set by the *Society*. The *FSA* is satisfied that *underwriting agents* will be subject to adequate financial resource and accounting requirements as long as they remain subject to and comply with requirements at least equivalent to Lloyd's Capital and Solvency Requirements 2001 and the relevant parts of, or requirements made under Lloyd's Underwriting Agents Byelaw (No. 4 of 1984), in each case as amended and in force immediately before *commencement*. Accordingly, instead of imposing an obligation directly on *underwriting agents*, the directions in *IPRU(INV)* 4.4.1D to 4.4.5D and 4.5.1D require the *Society* to require those firms to comply with the relevant requirements.
- 4.2.4 G A *members' adviser* is not regulated by the *Society* and accordingly this chapter specifies the financial resource and accounting requirements to be met. *Firms* which fall within the scope of this chapter will be *firms* with *permission* only to advise persons on *syndicate* participation at Lloyd's. The nature of that advisory business is akin to corporate finance advice and so the applicable requirements are those in *IPRU(INV)* 3 relevant to *firms* giving corporate finance advice. *Firms* with other *permissions* will fall within the scope of other chapters of *IPRU(INV)*.

4.3 SPECIFICATION OF OBJECTIVE

- 4.3.1 D The directions in *IPRU(INV)* 4.4.1D to 4.4.5D and 4.5.1D are given in relation to the exercise of the powers of the *Society* and of the *Council* generally, with a view to achieving the objective that *underwriting agents* have adequate financial resources to support, and keep and preserve adequate accounting records in respect of their business at Lloyd's.

4.4 FINANCIAL RESOURCE REQUIREMENTS

- 4.4.1 D The *Society* must maintain appropriate and effective arrangements to require *underwriting agents* to meet and continue to meet financial resource requirements at least equivalent to the requirements set out in Lloyd's Capital and Solvency Requirements 2001, as they are in force immediately before *commencement*.
- 4.4.2 D The *Society* must give the *FSA* a report on each *underwriting agent's* compliance with the financial resource requirements referred to in *IPRU(INV)* 4.4.1D as at the end of each quarter (determined by reference to each underwriting agent's *accounting reference date*).
- 4.4.3 D The report referred to in *IPRU(INV)* 4.4.2D must reach the *FSA* within two months of the end of the relevant quarter and must state:
- (1) whether the *Society* has any information indicating or tending to indicate that, during the quarter to which the report relates, the *underwriting agent* failed to meet the financial resource requirements referred to in *IPRU(INV)* 4.4.1D;
 - (2) whether, at the end of the quarter to which the report relates, the *underwriting agent* failed to meet the financial resource requirements referred to in *IPRU(INV)* 4.4.1D; and
 - (3) the nature and extent of any failure to comply reported under (1) or (2) and the actions taken or to be taken by the *Society* in response to this.
- 4.4.4 D In addition to the reports required under *IPRU(INV)* 4.4.2D, the *Society* must give the *FSA* an annual report on each *underwriting agent's* compliance or non-compliance with financial resource requirements as at the end of that *underwriting agent's* financial year.
- 4.4.5 D The report in *IPRU(INV)* 4.4.4D must reach the *FSA* within seven months of that *underwriting agent's* accounting reference date and must:
- (1) confirm that:
 - (a) the *Society* has received from that *underwriting agent* in respect of the financial year to which the report relates, all relevant attachments to the Annual Financial Return that the *underwriting agent* is required to make to the *Society* under the requirements identified in *IPRU(INV)* 4.4.1D;

- (b) that *underwriting agent* met the applicable financial resource requirements at the end of the financial year to which the report relates; and
 - (c) the *Society* is not aware of any matters likely to be of material concern to the *FSA* relating to that *underwriting agent's* compliance with financial resource requirements during the year to which the report relates, or arising from the attachments referred to in (a); or
- (2) if the *Society* is unable to give any of the confirmations required under *IPRU(INV)* 4.4.5D (1)(a), (b) or (c), set out in each case the reasons why it is unable to give that confirmation.
- 4.4.5A D The *Society* must submit the reports in *IPRU(INV)* 4.4.2D to *IPRU(INV)* 4.4.5D in accordance with the *rules* in *SUP* 16.3 (General provision on reporting).
- 4.4.6 R A *members' adviser* must comply with the requirements of *IPRU(INV)* 3-60(3) and 3-62.
- 4.5 ACCOUNTING RECORDS
- 4.5.1 D The *Society* must maintain appropriate and effective arrangements to require *underwriting agents* to meet the obligation to keep and preserve accounting records, set out in Lloyd's Underwriting Agents Byelaw (No 4 of 1984), Section III, paragraph 53B, as it is in force immediately before *commencement*.
- 4.5.2 R A *members' adviser* must comply with the requirements of *IPRU(INV)* 3-10 to 3-14.

Interim Prudential Requirements for Former IMRO Firms

5 CHAPTER 5: FINANCIAL RESOURCES

5.1.1 APPLICATION

APPLICATION OF CHAPTER 5

5.1.1(1)(a) R This chapter applies to an *investment management firm*, other than a *European investment firm*, as set out in Table 5.1.1(1)(a).

(b) R This chapter does not apply to a *European investment firm*.

TABLE 5.1.1(1)(a)		APPLICATION OF CHAPTER 5			
	ISD Firms	OPS Firms (see Note 1 below)	Non-OPS Life Offices and Non-OPS Local Authorities	Individuals admitted to membership collectively	
Financial resources rules					
5.2.1(1) to 5.2.7(5)	Yes	No	No	Yes	
Accounting records rules					
5.3.1(1) to 5.3.1(6)	Yes	Yes	Yes	Yes	
Financial notification rules					
5.5.1(1)	Yes	No	No	No	

	Individuals whose sole <i>investment business</i> is giving investment advice to institutional or corporate investors	<i>Firms</i> subject to "lead regulator arrangements"	All other <i>Firms</i>
Financial resources rules			
5.2.1(1) to 5.2.7(5)	No	No (see Note 2 below)	Yes
Accounting records rules			
5.3.1(1) to 5.3.1(6)	Yes	Yes	Yes
Financial notification rules			
5.5.1(1)	No	No	No
Note 1. <i>Firms</i> are referred to the specific compliance reports for <i>OPS firms</i> required by Chapter 16 of the Supervision Manual.			
Note 2. A <i>firm</i> subject to "lead regulator arrangements" whereby a body other than <i>the FSA</i> is responsible for its financial regulation shall comply with the corresponding financial resources rules and financial returns rules of that body, and a breach of such rules shall be treated as a breach of the rules of <i>the FSA</i>.			

INTERPRETATION

- (c) **R The definitions in the glossary at Appendix 1 apply to this chapter.**

5.2.1 GENERAL REQUIREMENT

ADEQUACY OF FINANCIAL RESOURCES

- 5.2.1(1) R **A firm must at all times have available the amount and type of *financial resources* required by the *rules* in this chapter.**

BASIC REQUIREMENT

- 5.2.1(2) R **A firm must ensure that, at all times, its *financial resources* are not less than its *financial resources requirement*.**

FINANCIAL RESOURCES

- 5.2.1(3) R **A firm's financial resources means:**

- (a) **its *own funds*, if the *firm* is subject to an *own funds requirement* under rule 5.2.3(2); or**
- (b) **its *liquid capital*, if the *firm* is subject to a *liquid capital requirement* under paragraph (a) of rule 5.2.3(1); or**
- (c) **where the *firm* is an *ISD firm* subject to an *own funds requirement* and a *liquid capital requirement* under paragraph (b) of rule 5.2.3(1), its *own funds* and its *liquid capital*; or**
- (d) **where the *firm* is an *ISD firm* and a trustee of an *authorised unit trust scheme* subject to paragraph (c) of rule 5.2.3(1), its *own funds* or its *liquid capital*.**

5.2.2 FINANCIAL RESOURCES

OWN FUNDS

- 5.2.2(1) R **A firm must calculate its *own funds* in accordance with Table 5.2.2(1).**

Liquid capital

- 5.2.2(2) R **A firm must calculate its *liquid capital* in accordance with Table 5.2.2(1).**

5.2.3 FINANCIAL RESOURCES REQUIREMENT

DETERMINATION OF REQUIREMENT

- 5.2.3(1)(a) R The *financial resources requirement* for a *firm* which is not an *ISD firm* is a *liquid capital requirement*, determined in accordance with paragraph (a) of rule 5.2.3(4), unless the *firm* falls within any of the exceptions in rule 5.2.3(2).
- (b) R The *financial resources requirement* for a *firm* which is an *ISD firm* is an *own funds requirement* determined in accordance with paragraph (b) of rule 5.2.3(3), and a *liquid capital requirement* calculated in accordance with paragraph (b) or (c) of rule 5.2.3(4).
- (c) R The *financial resources requirement* for a *firm* which is an *ISD firm*, but which is also a trustee of an *authorised unit trust scheme* or a *depository* of an *ICVC*, is the higher of an *own funds requirement* determined in accordance with paragraph (a)(i) of rule 5.2.3(3) and a *liquid capital requirement* calculated in accordance with paragraph (b) of rule 5.2.3(4).

EXCEPTIONS FROM THE LIQUID CAPITAL REQUIREMENT

- 5.2.3(2) R The *financial resources requirement* for a *firm* which is not an *ISD firm* is an *own funds requirement* determined in accordance with paragraph (a) of rule 5.2.3(3) if its *permitted business* does not include *establishing, operating or winding up a personal pension scheme* and:
- (a) the *firm's permitted business* does not include the holding of *customers' monies* or assets and it neither executes transactions (or otherwise arranges deals) in *investments* nor has such transactions executed for itself or its *customers*; or
- (b) the *firm's permitted business* includes the activities as in (a) above, but only in respect of venture capital investments for non-private customers; or
- (c) the *firm* is a *trustee* of an *authorised unit trust scheme* whose *permitted business* consists only of trustee activities and does not include any other activity constituting *specified trustee business* or the *firm* is a *depository* of an *ICVC* whose *permitted business* consists only of *depository* activities.
- (d) the *firm's permitted business* limits it to acting as the *operator* of a *collective investment scheme* whose main purpose is to invest in *permitted immovables* whether in the *UK* or abroad.

OWN FUNDS REQUIREMENT

- 5.2.3(3)(a) R** The *own funds requirement* for a *firm* subject to rule 5.2.3(2) is:
- (i) £4,000,000 for a firm which is a trustee of an authorised unit trust scheme or a depository of an ICVC;
 - (ii) £5,000 for any other *firm*.
- (b) R The *own funds requirement* for an *ISD firm* subject to paragraph (b) of rule 5.2.3(1) is an amount determined in accordance with Table 5.2.3(3)(b).

Liquid capital requirement

- 5.2.3(4)(a) R** The *liquid capital requirement* for a *firm* subject to paragraph (a) of rule 5.2.3(1) is the greater of:
- (i) £5,000; and
 - (ii) its *total capital requirement* calculated in accordance with rule 5.2.3(5).
- (b) R The *liquid capital requirement* for an *ISD firm* subject to paragraph (b) or (c) of rule 5.2.3(1) is its *total capital requirement* calculated in accordance with rule 5.2.3(5), unless paragraph (c) of rule 5.2.3(4) applies.
- (c) R The *liquid capital requirement* for an *ISD firm* whose *expenditure based requirement* consists of 6/52 of its *annual expenditure*, determined in accordance with Table 5.2.3(5)(a), is the greater of:
- (i) one quarter of its *annual expenditure* calculated in accordance with rule 5.2.4(1); and
 - (ii) its *total capital requirement* calculated in accordance with rule 5.2.3(5).

TOTAL CAPITAL REQUIREMENT

- 5.2.3(5) R** A firm's total capital requirement is the sum of its:
- (a) *expenditure based requirement* calculated in accordance with Table 5.2.3(5)(a);

- (b) **position risk requirement** calculated in accordance with Table 5.2.3(5)(b);
- (c) **counterparty risk requirement** calculated in accordance with Table 5.2.3(5)(c);
- (d) **foreign exchange requirement** calculated in accordance with Table 5.2.3(5)(d); and
- (e) **other assets requirement** calculated in accordance with Table 5.2.3(5)(e).

5.2.3(6) G **A firm** which discloses clients' money or assets on its balance sheet need not calculate the requirements under paragraphs (b) to (e) of rule 5.2.3(5) on such items where these do not represent assets or liabilities of the *firm* itself.

5.2.4 ANNUAL EXPENDITURE

DETERMINATION

5.2.4(1) R **Annual expenditure** is:

- (a) the amount described as total expenditure in the most recent **annual financial return**, less the following items (if they are included within such expenditure):
 - (i) **staff bonuses**, except to the extent that they are guaranteed;
 - (ii) **employees' and directors' shares in profits**, except to the extent that they are guaranteed;
 - (iii) **other appropriations of profits**;
 - (iv) **shared commission and fees payable which are directly related to commission and fees receivable which are included within total revenue**;
 - (v) **interest charges in respect of borrowings made to finance the acquisition of the firm's readily realisable investments**;
 - (vi) **interest paid to customers on client money**;
 - (vii) **interest paid to counterparties**;

(viii) **fees, brokerage and other charges paid to clearing houses, exchanges and intermediate brokers for the purposes of executing, registering or clearing transactions;**

(ix) **foreign exchange losses; or**

(b) **where the previous accounting period does not include twelve months' trading, an amount calculated in accordance with paragraph (a) above pro-rated to an equivalent annual amount; or**

(c) **where a *firm* has not prepared an *annual financial return* or *annual accounts* since the commencement of its *permitted business*, an amount based on forecast expenditure included in the budget for the first twelve months' trading, as submitted with its application for membership.**

5.2.4(2) G *A firm's financial resources requirement will be recalculated and, where required, audited annually when its annual financial return is prepared. The firm must maintain financial resources sufficient to meet its new financial resources requirement from the date on which the annual financial return is prepared, and where required, approved by the auditor. The expenditure based requirement applicable at the accounting reference date to which the annual financial return is prepared will be that based on the previous year's figures. This will usually be the same as that used in the fourth quarter's quarterly financial return prepared to the same accounting reference date.*

5.2.4(3) R **A firm's annual expenditure must be audited unless the firm is exempt from the provisions of Part VII of the Companies Act 1985 relating to the audit of accounts (section 249A (Exemptions from audit)).**

5.2.5 QUALIFYING SUBORDINATED LOANS

CHARACTERISTICS OF LONG TERM QUALIFYING SUBORDINATED LOANS

5.2.5(1) R **A long term *qualifying subordinated loan* (item 11 of Table 5.2.2(1)) must have the following characteristics:**

(a) **the loan is repayable only on maturity or on the expiration of a period of notice in accordance with paragraph (c) below or on the winding up of the *firm*;**

(b) **in the event of the winding up of the *firm*, the loan ranks after the claims of all other creditors and is not to be repaid until all other debts outstanding at the time have been settled; and**

- (c) **either:**
 - (i) **the minimum original maturity of the loan is 5 years; or**
 - (ii) **the loan does not have a minimum or fixed maturity but requires 5 years notice of repayment.**

Amount allowable in the calculation of own funds

- 5.2.5(2) R** *A firm* may only take into account the paid-up amount of a long term *qualifying subordinated loan* in the calculation of its *own funds*. This amount must be amortised on a straight-line basis over the five years prior to the date of repayment.

REQUIREMENTS APPLICABLE TO SHORT-TERM QUALIFYING SUBORDINATED LOANS

- 5.2.5(3)(a) R** A short term *qualifying subordinated loan* (item 15 of Table 5.2.2(1)) must have the characteristics set out in rule 5.2.5(1) save that the minimum period set out in paragraph (c) of rule 5.2.5(1) shall be two years.
- (b) R** *A firm* must not make any payment of principal or interest which would result in a breach of rule 5.2.1(2).

FORM OF QUALIFYING SUBORDINATED LOAN AGREEMENT

- 5.2.5(4) R** A *qualifying subordinated loan* must be in the form prescribed by *the FSA* for the purposes of this rule.
- 5.2.5(5) G** *Firms* wishing to initiate a subordinated loan agreement other than in the prescribed form are advised to contact *the FSA*.

CONDITIONS APPLICABLE TO QUALIFYING SUBORDINATED LOANS

- 5.2.5(6) R** *A firm* wishing to include a *qualifying subordinated loan* in its calculation of *liquid capital* must:
- (a)** provide *the FSA* with a copy of the agreement not less than 10 business days before the loan is to be made; and
- (b)** certify to the *FSA* that the loan agreement complies with the *FSA's* prescribed subordinated loan agreement.

REQUIREMENTS ON A FIRM IN RELATION TO QUALIFYING SUBORDINATED LOANS

- 5.2.5(7) R** *A firm* including a *qualifying subordinated loan* in its calculation of *liquid capital* must not:
- (a)** secure all or any part of the loan;
- (b)** redeem, purchase or otherwise acquire any of the liabilities of the borrower in respect of the loan;
- (c)** amend or concur in amending the terms of the loan agreement;

- (d) **repay all or any part of the loan otherwise than in accordance with the terms of the loan agreement; or**
- (e) **take or omit to take any action whereby the subordination of the loan or any part thereof might be terminated, impaired or adversely affected.**

5.2.6 QUALIFYING PROPERTY AND QUALIFYING UNDERTAKINGS

QUALIFYING PROPERTY AND QUALIFYING AMOUNT DEFINED

5.2.6(1) R *Qualifying property* is any freehold or leasehold (or the equivalent tenure in Scotland or other territories) land and buildings purchased or secured by way of a mortgage (or other form of secured long-term arrangement) where the security for the liability is the property (and does not include any other allowable assets). The *qualifying amount* is the lowest of:

- (a) **85 per cent of the current market value of the property (if known);**
- (b) **85 per cent of the net book value of the property;**
- (c) **the amount of the liability outstanding under mortgage or other secured long term arrangement, excluding any part of the liability repayable within one year.**

5.2.6(2) G Rule 5.2.6(1) can be illustrated as follows:

Current market value £200,000
Net book value £100,000
Mortgage £70,000, including £5,000 payable within one year

Qualifying amount is the lowest of:

(a) $85\% \times £200,000 = £170,000$

(b) $85\% \times £100,000 = £85,000$

(c) $£70,000 - £5,000 = £65,000$

i.e. £65,000

QUALIFYING UNDERTAKINGS

- 5.2.6(3) R** *A qualifying undertaking* is an arrangement between a *firm* and an *approved bank* which:
- (a) is in the form prescribed by *the FSA* for the purposes of this rule; and
 - (b) complies with the appropriate limitations set out in paragraph (7) of Part II to Table 5.2.2(1).

5.2.7 LARGE EXPOSURES

- 5.2.7(1) G *Firms* should note that rules 5.2.7(2) to (4) only apply to *ISD firms*; they have no application to *non-ISD firms*.

GENERAL REQUIREMENT

- 5.2.7(2) R** An *ISD firm* must be able to monitor its individual *large exposures*, and the total of its *large exposures*, on a daily basis, and must re-calculate its *large exposures* position in a full and detailed manner before executing any transaction which may result in a breach of the limits set out in rule 5.2.7(3).

LARGE EXPOSURE LIMITS

- 5.2.7(3) R** Subject to rule 5.2.7(4), an *ISD firm* must ensure that:
- (a) each *large exposure* does not exceed 25 per cent of its *own funds*, or 20 per cent of *its own funds* where the exposure is to an *associate* of the *firm*; and
 - (b) the aggregate of its *large exposures* does not exceed 800 per cent of its *own funds*.

EXCEPTION TO THE LARGE EXPOSURE LIMITS

- 5.2.7(4) R** An *ISD firm* may exclude an *exempt exposure* from the calculation of its *large exposures*, and may reduce that calculation by an appropriate amount, where an *exposure* is a *partially exempt exposure*.

TRANSITIONAL ARRANGEMENTS

- 5.2.7(5) R **A large exposure to which a firm was legally bound, on or before 5 February 1993, may be continued until its contractual maturity.**

TABLE 5.2.2(1) CALCULATION OF OWN FUNDS AND LIQUID CAPITAL

**PART I
METHOD OF CALCULATION**

A firm must calculate its own funds and liquid capital as shown below, subject to the detailed requirements set out in Part II.

Financial resources	Category	Part II Para
Tier 1		
(1) Paid-up share capital (excluding preference shares)	A	2
<i>(1A) Eligible LLP members' capital</i>		
(2) Share premium account		
(3) Reserves		2A
(4) Non-cumulative preference shares		
Less: (5) Investments in own shares	B	
(6) Intangible assets		3
(7) Material current year losses		4
(8) Material holdings in credit and financial institutions		5
<i>(8A) Excess LLP members' drawings</i>		
Tier 1 capital = (A-B)	C	
Plus: TIER 2		1
(9) Revaluation reserves	D	

(10) Fixed term cumulative preference share capital		1(a)
(11) Long-term Qualifying Subordinated Loans		1(a); 6
<hr/>		
(12) Other cumulative preference share capital and debt capital		
(13) Qualifying arrangements		7
"Own Funds" = (C+D)	E	
Plus: TIER 3		
(14) Net trading book profits	F	1(b)(i); 8
(15) Short-term Qualifying Subordinated Loans and excess Tier 2 capital		1(b)(ii); 1(c); 9
Less: (16) Illiquid assets	G	10
Add: (17) Qualifying Property		11
"Liquid Capital" = (E+F+G)		

PART II DETAILED REQUIREMENTS

1 Ratios

(Items 10, 11 and 15)

(a) For a *firm* which is an *ISD firm*, in calculating *own funds*, the following restriction applies:

the total of fixed term cumulative preference shares (item 10) and long-term *qualifying subordinated loans* (item 11) that may be included in Tier 2 capital is limited to 50 per cent of Tier 1 capital. (But see sub-paragraph (b)(ii) below.)

(b) For a *firm* which is an *ISD firm*, in calculating *liquid capital*:

(i) Tier 2 capital must not exceed 100 per cent of Tier 1 capital;

(ii) capital which would otherwise qualify as Tier 2 capital but for the operation of paragraphs 1(a) and 1(b)(i) may be treated as Tier 3 capital subject to sub-paragraph (iii) below; and

	<p>(iii) the total of the excess of Tier 2 capital so treated as Tier 3 capital and short-term <i>qualifying subordinated loans</i> (item 15) may not exceed 250 per cent of an amount equal to Tier 1 capital less the <i>other assets requirements</i> calculated in accordance with Table 5.2.3(5)(e).</p> <p>(c) A <i>firm</i> which is not an <i>ISD firm</i> and which is subject to a <i>liquid capital requirement</i> under rule 5.2.3(1)(a) may take into account <i>qualifying subordinated loans</i> in the calculation of <i>liquid capital</i> up to a maximum of 400% of its Tier 1 capital.</p>
<p>2 Non corporate entities</p>	<p>(a) In the case of partnerships or sole traders, the following terms should be substituted, as appropriate, for items 1 to 4 in Tier 1 capital:</p> <ul style="list-style-type: none"> (i) partners' capital accounts (excluding loan capital); (ii) partners' current accounts (excluding unaudited profits and loan capital); (iii) proprietors' account (or other term used to signify the sole trader's capital but excluding unaudited profits). <p>(b) Loans other than <i>qualifying subordinated loans</i> shown within partners' or proprietors' accounts must be classified as Tier 2 capital under item 12.</p> <p>(c) For the calculation of <i>own funds</i>, partners' current accounts figures are subject to the following adjustments in respect of a <i>defined benefit occupational pension scheme</i>:</p> <ul style="list-style-type: none"> (i) a <i>firm</i> must derecognise any <i>defined benefit asset</i>; (ii) a <i>firm</i> may substitute for a <i>defined benefit liability</i> the <i>firm's deficit reduction amount</i>. The election must be applied consistently in respect of any one financial year. <p>Note A <i>firm</i> should keep a record of and be ready to explain to its supervisory contacts in the <i>FSA</i> the reasons for any difference between the <i>deficit reduction amount</i> and any commitment the <i>firm</i> has made in any public document to provide funding in respect of a <i>defined benefit occupational pension scheme</i>.</p>
<p>2A Reserves</p>	<p>For the calculation of <i>own funds</i> the following adjustments apply to the audited reserves figure:</p> <ul style="list-style-type: none"> (a) a <i>firm</i> 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; (b) in respect of a <i>defined benefit occupational pension scheme</i>, a <i>firm</i> must derecognise

any *defined benefit asset*;

- (c) 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

Note 1

A *firm* should keep a record of and be ready to explain to its supervisory contacts in the *FSA* 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*.

- (d) a *firm* must not include any unrealised gains from investment property.

Note

Unrealised gains from investment property should be reported as part of revaluation reserves.

- (e) 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 exclude from the deduction or addition any asset or liability which will give rise to future cash flows), together with any associated deferred tax.

Note 2

Reserves must be audited unless the *firm* is exempt from the provisions of Part VII of the Companies Act 1985 relating to the audit of accounts (section 249A (Exemptions from audit)).

3 Intangible assets
(Item 6)

Intangible assets comprise:

- (a) formation expenses to the extent that these are treated as an asset in the *firm's* accounts;
(b) goodwill, to the extent that it is treated as an asset in the *firm's* accounts; and
(c) other assets treated as intangibles in the *firm's* accounts.

Intangible assets do not include a deferred acquisition cost asset.

4. Material current year losses (Item 7)

Losses in current year operating figures must be deducted when calculating Tier 1 capital if such losses are material. For this purpose profits and losses must be calculated quarterly or monthly, as appropriate. If this calculation reveals a net loss it shall only be deemed to be material for the purposes of this Table if it exceeds 10 per cent of the *firm's* Tier 1 capital.

<p>5 Material holdings in credit and financial institutions (Item 8)</p>	<p>Material holdings comprise:</p> <p>(a) where the <i>firm</i> holds more than 10 per cent of the equity share capital of the institution, the value of that holding and the amount of any subordinated loans to the institution and the value of holdings in <i>qualifying capital items</i> or <i>qualifying capital instruments</i> issued by the institution;</p> <p>(b) in the case of holdings other than those mentioned in (a) above, the value of holdings of equity share capital in, and the amount of subordinated loans made to, such institutions and the value of holdings in <i>qualifying capital items</i> or <i>qualifying capital instruments</i> issued by such institutions to the extent that the total of such holdings and subordinated loans exceeds 10 per cent of the <i>firm's own funds</i> calculated before the deduction of item 8.</p>
<p>6 Long term qualifying subordinated loans (Item 11)</p>	<p>Loans having the characteristics prescribed by rule 5.2.5(1) may be included in item 11, subject to the limits set out in paragraph (1) above.</p>
<p>7 Qualifying arrangements (Item 13)</p>	<p>(a) An <i>ISD firm</i> may only include a <i>qualifying undertaking</i> or other arrangement in item 13 if it is a <i>qualifying capital instrument</i> or a <i>qualifying capital item</i>.</p> <p>(b) A <i>firm</i> which is not an <i>ISD firm</i> may only include <i>qualifying undertakings</i> in its calculation of <i>liquid capital</i> if:</p> <p>(i) it maintains <i>liquid capital</i> equivalent to 6/52 of its <i>annual expenditure</i> in a form other than <i>qualifying undertakings</i>; and</p> <p>(ii) the total amount of all <i>qualifying undertakings</i> plus <i>qualifying subordinated loans</i> does not exceed the limits set out in paragraph (1)(c) above.</p>
<p>8 Net trading book profits (Item 14)</p>	<p>For <i>non-ISD firms</i> the unaudited profits can be included at item 14. For <i>ISD firms</i> the amount which may be included at item 14 must comprise the <i>firm's trading book</i> profits less any foreseeable charges or dividends and any losses suffered in respect of its other business, save to the extent that these have been taken into account in calculating item 3 and/or item 7 of Part I.</p>

Note

Non-trading book interim profits may only be included in Tier 1 of the calculation if they have been independently verified by the *firm's* external auditors, unless the *firm* is exempt from the provisions of Part VII of the Companies Act 1985 relating to the audit of accounts (section 249A (Exemptions from audit)).

For this purpose, the external auditor should normally undertake at least the following:

- (a) satisfy himself that the figures forming the basis of the interim profits have been properly extracted from the underlying accounting records;
- (b) review the accounting policies used in calculating the interim profits so as to obtain comfort that they are consistent with those normally adopted by the *firm* in drawing up its annual financial statements;
- (c) perform analytical review procedures on the results to date, including comparisons of actual performance to date with budget and with the results of prior periods;
- (d) discuss with management the overall performance and financial position of the *firm*;
- (e) obtain adequate comfort that the implications of current and prospective litigation, all known claims and commitments, changes in business activities and provisions for bad and doubtful debts have been properly taken into account in arriving at the interim profits; and
- (f) follow up problem areas of which the auditors are already aware in the course of auditing the *firm's* financial statements.

A *firm* wishing to include interim profits in Tier 1 capital in a *financial return* should submit to the FSA with the *financial return* a verification report signed by its external auditor which states whether the interim results are fairly stated, unless the *firm* is exempt from the provisions of Part VII of the Companies Act 1985 relating to the audit of accounts (section 249A (Exemptions from audit)).

<p>9 Short term qualifying subordinated loans (Item 15)</p>	<p>Profits on the sale of capital items or arising from other activities which are not directly related to the <i>investment business</i> of the <i>firm</i> may also be included within the calculation of <i>liquid capital</i>, but (unless the firm is exempt as above) only if they can be separately verified by the <i>firm's</i> auditors. In such a case, such profits can form part of the <i>firm's</i> Tier 1 capital as profits.</p> <p>Loans having the characteristics prescribed by rule 5.2.5(3) may be included in item 15 subject to the limits set out in paragraph (1) above. Tier 2 capital which exceeds the ratios prescribed by paragraph (1)(a) and (b) may be included in item 15 subject to paragraph (1) above.</p>
<p>10 Illiquid assets (Item 16)</p>	<p>Illiquid assets comprise:</p> <p>(a) tangible fixed assets;</p> <p>Note In respect of tangible fixed assets purchased under finance leases the amount to be deducted as an illiquid asset shall be limited to the excess of the asset over the amount of the related liability shown on the balance sheet.</p> <p>(b) holdings in, including subordinated loans to, <i>credit</i> or <i>financial institutions</i> which may be included in the <i>own funds</i> of such <i>institutions</i> unless they have been deducted under item 8;</p> <p>(c) any <i>investment</i> in undertakings other than <i>credit institutions</i> and other <i>financial institutions</i> where such <i>investments</i> are not readily realisable;</p> <p>(d) any deficiency in net assets of a <i>subsidiary</i>;</p> <p>(e) deposits not available for repayment within 90 days or less (except for payments in connection with margined futures or options contracts);</p> <p>Note Where cash is placed on deposit with a maturity of more than 90 days but is repayable on demand subject to the payment of a penalty, then this is not required to be deducted as an illiquid asset but a deduction is required for the amount of the penalty.</p> <p>(f) loans, other debtors and accruals not falling due to be repaid within 90 days or which are more than one month overdue by reference to the contractual payment date;</p>

- (g) physical stocks (except where subject to the *position risk requirement* as set out in Table 5.2.3(5)(b); and
- (h) prepayments to the extent that the period of prepayment exceeds six weeks in the case of a *firm* subject to the *6/52 expenditure based requirement* or thirteen weeks in the case of a *firm* subject to the *13/52 expenditure based requirement* or where a *firm* is required to meet the requirement in rule 5.2.3(4)(c)(i).
- (i) if not otherwise covered, any holding in eligible capital instruments of an insurance undertaking, insurance holding company, or reinsurance undertaking that is a *subsidiary* or *participation*. Eligible capital instruments include ordinary share capital, cumulative preference shares, perpetual securities and long-term subordinated loans, that are eligible for insurance undertakings under PRU 2.

Illiquid assets do not include a *defined benefit asset* or a deferred acquisition cost asset.

11 *qualifying property*
(Item 17)

This item comprises the qualifying amount calculated in accordance with rule 5.2.6(1).

Table 5.2.3(3)(b)

OWN FUNDS REQUIREMENT

**PART I
DETERMINATION OF REQUIREMENT**

- 1 Subject to paragraph 2 below, an *ISD firm's own funds requirement* is:
- (a) Euro730,000 for a *firm* whose *permitted business* includes dealing for its own account and/or underwriting issues; *or*
 - (b) Euro125,000 for a *firm* whose *permitted business* includes holding *customers' monies* or assets, but does not include dealing for its own account or underwriting issues; *or*
 - (c) Euro50,000 for a *firm* whose *permitted business* does not include holding *customers' monies* or assets, dealing for its own account or underwriting issues;

unless, in each case, the *firm* qualifies for a lower amount in accordance with Part II.

- 2 An *ISD firm* will not require permission to deal for its own account for the purposes of determining its *own funds requirement* if it holds positions and:
- (a) (i) such positions arise as a result of the *firm's* failure to match investors' orders precisely;
 - (ii) the positions are incidental and provisional in nature, only lasting long enough to complete the transaction in question; and**
 - (iii) the total market value of all such positions does not exceed 15 per cent of the *firm's* Tier 1 capital; or
 - (b) such positions are held for investment, and not for short term trading, purposes; or
 - (c) such positions arise in the course of correcting a dealing error connected with a *customer transaction*.

**PART II
OWN FUNDS TRANSITIONAL PROVISIONS**

1 [deleted]

2 (a) [deleted]

(b) [deleted]

(c) [deleted]

(d) [deleted]

3 [deleted]

4 [deleted]

Table 5.2.3(5)(a) EXPENDITURE BASED REQUIREMENT

**PART I
CALCULATION OF REQUIREMENT**

A firm's expenditure based requirement is a fraction of its annual expenditure determined in accordance with Part II of this Table.

**PART II
FRACTIONS**

1 The fraction is 6/52 where:

- (a) the *firm* is an *authorised unit trust manager*; or
- (b) the *firm* acts only as an *authorised corporate director* of an *ICVC*; or
- (c) the *firm* is:
 - (i) an *investment manager* (including the *operator* of an *unregulated collective investment scheme* in relation to which the *firm* carries on the activity of an *investment manager*); or

(ii) one whose *permitted business* includes *establishing, operating or winding up a personal pension scheme*,

unless paragraph 2 applies.

2 The fraction is 13/52 where the *firm* is:

- (a) an *investment manager* as in paragraph 1(c)(i) above;
 - (b) one whose *permitted business* includes *establishing, operating or winding up a personal pension scheme*; or
 - (c) a *custodian*,
- and the *firm*:
- (d) itself holds *customers' monies* or assets; or
 - (e) procures the appointment as *custodian* of its *customers' monies* or assets of an *associate* of the *firm* which is not an *approved bank*.

Note: Paragraph 1(a) above includes a *firm* which acts as both an *authorised unit trust manager* and as an *authorised corporate director* of an *ICVC*.

Table 5.2.3(5)(b) POSITION RISK REQUIREMENT

**PART I
CALCULATION OF REQUIREMENT**

A firm's position risk requirement is determined by calculating on a daily mark to market basis, the sum of the weighted value of each position held by the firm. The weighted value for each position must be calculated by multiplying its current market value by the appropriate factor set out in Part II.

Note: This requirement does not attach to items deducted in full as illiquid assets.

**PART II
WEIGHTINGS**

Instrument	Requirement			
A Debt	Maturity	0-2 years	2-5 years	>5 years
Central Government		2%	5%	13%
Qualifying debt securities				
• fixed rate		8%	8%	15%
• floating rate		10%	10%	15%
Non-qualifying debt securities				
• fixed rate		10%	20%	30%
• floating rate		30%	30%	30%

B	Equities	
•	Traded on a <i>recognised or designated investment exchange</i> .	25%
•	other	100%
C	Stock position in physical commodities	
•	Physical positions associated with <i>firm's investment business</i>	30% of realisable value
D	Derivatives	
•	Exchange traded futures and written options	4 x initial margin requirement.
•	otc futures and written options	Apply the appropriate percentage shown in Sections A, B, & C above to the market value of the underlying position.
•	Purchased options	Apply the appropriate percentage shown in Sections A, B & C above to the market value of the underlying position but the result may be limited to the market value of the option.
•	Contracts for differences	20% of the market value of the contract.
E	Other <i>investments</i>	
•	units in <i>regulated collective investment schemes</i>	25% of realisable value (see Section F).
•	with profit <i>life policies</i>	20% of surrender value.
•	other	100% of the value of investment or underlying instrument.

F Determination of disallowed value of units

The disallowed value of units held in a *unit trust manager's* box is the difference between:

- (a) the amount at which stocks of units in the box are valued in the balance sheet; and
- (b) the adjusted value of the units, being the value of the units calculated at cancellation prices less the value calculated at cancellation prices of the units multiplied by the following percentages based on the types of *investments* in the individual *unit trust schemes*:

Quoted, fixed or floating rate interest bearing securities: 3%

Equities:

USA, Japan, Canada 5%
 Europe 6%
 Far East and other 10%

Note

This can be illustrated as follows:
 100 units, comprising Far East equities, with unit cancellation price of 100 pence.

	£	£
Balance sheet value		104
Value of cancellation price	100	
Less £100 x 10%	10	90
Disallowed	10	14

Note

The percentages in the requirement column are applied to the market value (unless otherwise stated) of gross positions i.e. both longs and shorts in each category; netting and off-setting are prohibited. The long or short position in a particular instrument is the net of any long or short positions held in that same instrument.

Table 5.2.3(5)(c) COUNTERPARTY RISK REQUIREMENT (CRR)

1 Receivables

In the case of receivables due to the *firm* in the form of fees, commission, interest, dividends and margin in exchange-traded futures or options contracts, which are directly related to items included in the *trading book*, the CRR is calculated as follows:

$$\text{CRR} = A \times \text{RF, where}$$

A = the amount of the sum due; and

RF = the appropriate risk factor derived from Table 5.2.3(5)(c)(ii).

Note

This requirement attaches only to balances arising from proprietary activity falling within the definition of the *trading book*.

Note

This requirement does not attach to items deducted in full as illiquid assets.

2 Delivery of cash against documents

Where a *firm* enters into a *trading book* transaction and the transaction is to be settled by delivery of cash against documents, the *firm's* CRR in respect of that transaction is calculated as follows:

$$\text{CRR} = (\text{SP} - \text{MV}) \times \text{RF, where}$$

SP = agreed settlement price;

MV = current market value;

RF = the appropriate risk factors derived from Table 5.2.3(5)(c)(i).

The CRR should only be calculated where the difference between SP and MV would involve a loss if borne by the *firm*.

<p>3 Free deliveries</p>	<p>Where a <i>firm</i> enters into a <i>trading book</i> transaction and the <i>firm</i> pays for the securities before it receives documents of title or delivers documents of title before receiving payment, the CRR in respect of that transaction is calculated as follows:</p> $\text{CRR} = V \times \text{RF}, \text{ where}$ <p>V = (i) the full amount due to the <i>firm</i> (i.e. the contract value) where the <i>firm</i> has delivered securities to a counterparty and has not received payment; or</p> <p>(ii) the market value of the securities, where the <i>firm</i> has made payment to a counterparty for securities and has not received documents of title; and</p> <p>RF = the appropriate risk factor derived from Table 5.2.3(5)(c)(ii).</p>
<p>4 Settlement outstanding 30 days or more</p>	<p>In the case of trading book transactions entered into by a <i>firm</i> where the <i>firm</i> pays for the securities before it receives documents of title or delivers documents of title before receiving payment and settlement has not been effected within 30 days of falling due, $\text{CRR} = V$.</p>
<p>5 Repos/Stock Lending and Reverse Repos/Stock Borrowing</p>	<p>Where a <i>firm</i> enters into a transaction based on securities included in the trading book under the terms of a repurchase agreement or a securities lending agreement the <i>firm's</i> CRR in respect of that transaction is calculated as follows:</p> $\text{CRR} = V \times \text{RF}, \text{ where}$ <p>RF = the appropriate risk factor derived from Table 5.2.3(5)(c)(ii); and</p> <p>for repos/stock lending:</p> <p>V = the excess of the market value of the securities over the value of the collateral provided under the agreement, if the net figure is positive; or</p>

for reverse repos/stock borrowing:

V = the excess of the amount paid or the collateral given for the securities received under the agreement, if the net figure is positive.

6 otc derivatives

In the case of a transaction entered into by a *firm* as principal in an *otc derivative* the CRR is calculated as follows:

CRR = A x RF, where

A = the appropriate credit equivalent amount derived from Table 5.2.3(5)(c)(iii); and

RF = the appropriate risk factor derived from Table 5.2.3(5)(c)(ii).

This calculation shall not apply to contracts for interest rate and foreign exchange which are traded on a *recognised investment exchange* or *designated investment exchange* where they are subject to a daily margin requirement and foreign exchange contracts with an original maturity of 14 calendar days or less.

A *firm* may net off contracts with the same counterparty in the same *otc derivative* contract for settlement on the same date in the same currency provided that the *firm* is legally entitled under the terms of the contracts with such a counterparty to net such contracts by novation.

Table 5.2.3(5)(c)(i)

COUNTERPARTY RISK FACTOR – CASH SETTLEMENTS

Number of working days after due settlement date	Risk Factor
0-4	0%
5-15	8%
16-30	50%
31-45	75%
46 or more	100%

Table 5.2.3(5)(c)(ii) COUNTERPARTY RISK REQUIREMENT

Type of <i>counterparty</i>		Risk Weighting	Solvency Ratio	Risk Factor
1	A counterparty which is, or the contract of which is, explicitly guaranteed by a <i>category a body</i> .	NIL	8%	NIL
2	A counterparty which is, or the contract of which is, explicitly guaranteed by a <i>category b body</i> .	20%	8%	1.6%
3	Any other counterparty.	100%	8%	8%

Table 5.2.3(5)(c)(iii)

OTC DERIVATIVES CALCULATION OF CREDIT EQUIVALENT AMOUNT

A By attaching current market values to contracts (marking to market), obtain the current replacement cost of all contracts with positive values.

B To obtain a figure for potential future credit exposure, the notional principal amounts or values underlying the *firm's* aggregate positions are multiplied by the following percentages:

Residual Maturity	Interest-Rate Contracts	Foreign-Exchange Contracts
One year or less	nil	1%
More than one year	0.5%	5%

C The credit equivalent amount is the sum of current replacement cost and potential future credit exposure.

Note

Except in the case of single-currency "floating/floating interest rate" swaps in which only the current replacement cost will be calculated, bought OTC equity options and covered warrants shall be subject to the treatment accorded to exchange rate contracts.

Table 5.2.3(5)(d) FOREIGN EXCHANGE REQUIREMENT

Calculation of Requirement

(1) A firm's foreign exchange requirement is determined by calculating the excess of its foreign exchange position (FEP) above 2 per cent of its own funds and multiplying this excess by 8 per cent.

(2) The FEP is the greater of:

- (a) the total in the reporting currency of the net short positions in each currency other than the reporting currency; and
- (b) the total in the reporting currency of the net long positions in each currency other than the reporting currency;

where the conversion to the reporting currency is performed using spot rates.

Note

For this purpose, long and short positions in the same currency can be netted to produce the net position.

(3) In calculating the FEP, a firm must include relevant foreign exchange items.

EXCHANGE POSITION FOR HEDGING PURPOSES

Any positions which the firm has taken in order to hedge against the adverse effect of exchange rates on an item already deducted in the calculation of liquid capital may not be excluded from the calculation of net open currency positions.

Table 5.2.3(5)(e) OTHER ASSETS REQUIREMENT

**PART I
CALCULATION OF REQUIREMENT**

The requirement to be met in respect of the assets set out in Part II of this Table, other than those to which *position risk requirements* and *counterparty risk requirements* apply or which have been deducted in full as illiquid assets, and in respect of off-balance sheet items set out in Part II of this Table, must be calculated as follows:

- A = AV x RF where
- A = the amount of the requirement;
- AV = the current asset value; and
- RF = the appropriate risk factor derived from Part II of this Table.

**PART II
RISK FACTORS**

Assets and Off-Balance Sheet Items	Risk Factor
Assets	
Cash at bank and in hand and equivalent items Assets secured by acceptable collateral including deposits and certificates of deposit with lending institutions	NIL
Amount due from trustees of authorised unit trusts	NIL
Note	
This only applies to <i>firms</i> who are <i>authorised unit trust managers</i> in relation to authorised unit trusts they manage.	
Amount due from <i>depositories</i> of <i>ICVC's</i>	
Note	NIL
This only applies to <i>firms</i> who are <i>authorised corporate directors</i> in relation to <i>ICVC's</i> they operate	
Other receivables due from or explicitly guaranteed by or deposits with <i>category a bodies</i>	NIL

Other receivables due from or explicitly guaranteed by or deposits with <i>category b</i> bodies	1.6%
Pre-payments and accrued income (See paragraph 10 of Part II of Table 5.2.2(1))	8%
Defined benefit asset	NIL
Deferred acquisition cost asset	NIL
All other assets	8%
OFF-BALANCE SHEET ITEMS	
Full Risk Items e.g.	
Charges granted against assets	8% x counterparty weight (see Table 5.2.3(5)(c)(ii))
Guarantees given	
Medium Risk Items e.g.	
Undrawn credit facilities granted by the <i>firm</i> with an original maturity of more than one year	4% x counterparty weight (see Table 5.2.3(5)(c)(ii))
Low Risk Items e.g.	
Undrawn credit facilities granted by the <i>firm</i> with an original maturity of one year or less	Nil

Note

- (1) In determining the appropriate *other assets requirement* (OAR) for guarantees given in a group context, a *firm* should follow the calculation below:
- (a) Categorise the guarantee agreements into:
 - (i) those with the character of credit substitutes; or
 - (ii) those not having the character of credit substitutes; or
 - (iii) agreements to provide guarantees.**
 - (b) Calculate the weighted value.
 - (i) For guarantees falling under (1)(a)(i), the weighted value will be 100% of the estimated current year liability under the guarantee.
 - (ii) For guarantees falling under (1)(a)(ii) the weighted value will be 50% of the estimated current year liability under the guarantee.
 - (iii) For guarantees falling under (1)(a)(iii), the weighted value will be nil.
 - (c) The OAR is calculated as:

Weighted value x 8% x counterparty weighting (Table 5.2.3(5)(c)(ii))
- (2) For the purpose of this requirement, in assessing whether the guarantee has the characteristics of a credit substitute the following factors should be considered:
- (a) do the agreements allow for periodic or ad-hoc calling of funds;
 - (b) have the guarantees been drawn upon on a regular basis;
 - (c) do *firms* in the group rely on such guarantees to meet their working capital or regulatory capital requirements.
- (3) Where a *firm* is part of a group including other *FSA* regulated entities which together have entered into cross group guarantee arrangements which give rise to an OAR, the estimate of the potential liability under the guarantee may be apportioned between the regulated entities for the purpose of calculating each *firm's* OAR.

5.3.1 RECORDS

RECORDING REQUIREMENTS

- 5.3.1(1) R A *firm* must ensure that it maintains adequate accounting records and must prepare and submit such reports as are required by *the FSA* in a timely manner. A *firm's* records must:
- (1) be up to date and must disclose, with reasonable accuracy, at any time, the *firm's* financial position at that time;
 - (2) enable the *firm* to demonstrate its continuing compliance with its *financial resources requirements*; and
 - (3) provide the information:
 - (a) which the *firm* needs to prepare such financial statements and periodical reports as may be required by *the FSA*; and
 - (b) which the *firm's* auditor (where *the FSA* requires one to be appointed) needs to form an opinion on any statements of the *firm* on which the auditor is required to report.
- 5.3.1(2) G Where a *firm* appoints a third party to maintain the *firm's* accounting records, these records remain the responsibility and property of the *firm*, which must ensure that they are maintained in accordance with the *rules*.

FIRM'S OWN TRANSACTIONS

- 5.3.1(3) R A *firm* must ensure that proper accounting records are kept in English to show and explain the *firm's own account transactions*, distinguishing between *trading book* and *non-trading book* transactions.

CUSTOMERS' ACCOUNTING RECORDS

- 5.3.1(4) R A *firm* must ensure that proper accounting records are kept in English which:
- (1) record all purchases and sales of *customers' assets* effected by the *firm*;
 - (2) record all receipts and payments of money belonging to *customers* which arise from transactions effected by the *firm*;
 - (3) in relation to *client money*; have regard to the requirements of the *Client Money Rules*;
 - (4) disclose the assets and liabilities of a *firm's customers* individually and collectively, to the extent that they are managed by the *firm*;

- (5) record all *customers' assets* (including *customer investments*) in the possession of the *firm* or of another person who is holding such assets for, or to the order of, the *firm*, showing the location of the assets, their beneficial owner and the extent to which they are subject to any charge of which the *firm* has been notified.
- 5.3.1(5) G The requirement to maintain adequate records of movements and holdings of *client money* and any interest paid on *client money* balances, are set out in CASS 4.1 to 4.3.

RETENTION OF ACCOUNTING RECORDS

- 5.3.1(6) R The accounting records required by rule 5.3.1(1) to (4) must be maintained for a minimum period of six years. During the first two of these years they must be kept either at a place where the *firm* carries on business or in such a manner that they can be produced at such a place within 24 hours of their being requested.

5.5.1 FINANCIAL NOTIFICATION

NOTIFICATION REQUIREMENTS FOR ISD FIRMS

- 5.5.1(1) R An *ISD firm* must notify *the FSA* in writing as soon as it has reason to believe that any of the following has occurred:
- (a) a counterparty in a repo or reverse repo transaction or a securities lending or borrowing transaction has defaulted; or
 - (b) the *firm* is in breach of the requirement to maintain *own funds* in excess of its *own funds requirement*; or
 - (c) it is in breach of the large exposures limits set out in rule 5.2.7(3).

5.7 CONSOLIDATED SUPERVISION

Under the Financial Conglomerates and Other Financial Groups Instrument 2004, the rules in Chapter 14 shall (with respect to a particular firm, group or financial conglomerate) apply from the first day of its financial year beginning in 2005 in place of rules 5.7.1(1) to 5.7.5(4).

5.7.1 [deleted]

5.7.2 [deleted]

5.7.3 **[deleted]**

5.7.4 **[deleted]**

5.7.5 **[deleted]**

APPENDIX 1 (INTERPRETATION)

GLOSSARY OF TERMS FOR CHAPTER 5 (FORMER IMRO FIRMS)

The following words or terms throughout Chapter 5 are to have the meanings given to them below if not inconsistent with the subject or context. If a defined term does not appear in the IPRU(INV) 5 glossary below, the definition appearing in the main Handbook *Glossary* applies.

Term	Meaning
<i>accepting deposits</i>	means the <i>regulated activity</i> , specified in article 5 of the <i>Regulated Activities Order (Accepting deposits)</i> , which is in summary: <i>accepting deposits</i> if: <ul style="list-style-type: none">(a) money received by way of <i>deposit</i> is lent to others; or(b) any other activity of the person accepting the <i>deposit</i> is financed, wholly or to a material extent, out of the capital of or interest on money received by way of <i>deposit</i>.
<i>accounting reference date</i>	means: <ul style="list-style-type: none">(a) the date to which a <i>firm's</i> accounts are prepared in order to comply with the <i>Companies Act</i> or, in the case of a <i>firm</i> not subject to the <i>Companies Act</i>, the equivalent date selected by the <i>firm</i>; and(b) in the case of an <i>OPS firm</i> which is not subject to the <i>Companies Act</i>, the date to which the accounts of the <i>OPS</i> in respect of which the <i>firm</i> acts are prepared.
<i>Act</i>	means the Financial Services and Markets Act 2000.
<i>advice or advising on investments</i>	means the <i>regulated activity</i> , specified in article 53 of the <i>Regulated Activities Order (Advising on investments)</i> , which is in summary: advising a person if the advice is <ul style="list-style-type: none">(a) given to the person in his capacity as an investor or potential investor, or in his capacity as agent for an investor or a potential investor; and(b) advice on the merits of his doing any of the following (whether as principal or agent):<ul style="list-style-type: none">(i) buying, selling, subscribing for or underwriting a particular <i>investment</i> which is a <i>designated investment</i>, or(ii) exercising any right conferred by such an <i>investment</i> to buy, sell, subscribe for or underwrite such an <i>investment</i>.
<i>admission procedures</i>	means the procedures set out in the Authorisation Manual together with any other procedures which the <i>Board</i> resolves, either generally or in relation to any specific case, should apply to the admission of <i>firms</i> and the admission of <i>approved persons</i> .
<i>ancillary activity</i>	means an activity that is not a <i>regulated activity</i> but is: <ul style="list-style-type: none">(a) carried on in connection with a <i>regulated activity</i>; or(b) held out as being for the purposes of a <i>regulated activity</i>.
<i>ancillary investment services undertaking</i>	means an undertaking the principal activity of which consists in owning or managing property, managing data-processing services, or any other similar activity which is ancillary to the principal activity of one or more <i>investment management firms</i> .
<i>annual accounts</i>	means accounts prepared to comply with the <i>Companies Act</i> or other statutory obligations.
<i>annual audited expenditure</i>	has the meaning given in rule 5.2.4(1) (Determination).
<i>annual financial return</i>	means the return referred to in the Supervision Manual.
<i>appointed</i>	(in accordance with section 39 of the <i>Act</i>) a <i>person</i> (other than an <i>authorised person</i>) who:

- representative* (a) is a party to a contract with an *authorised person* (his *principal*) which:
- (i) permits or requires him to carry on business of a description prescribed in the Financial Services and Markets Act 2000 (Appointed Representatives) Regulations 2001 (SI 2001/1217); and
 - (ii) complies with such requirements as are prescribed in those Regulations; and
- (b) is someone for whose activities in carrying on the whole or part of that business his *principal* has accepted responsibility in writing;
- and who is therefore an *exempt person* in relation to any *regulated activity* comprised in the carrying on of that business for which his *principal* has accepted responsibility.
- approved bank* (in relation to a bank account opened by a *firm*):
- (a) if the account is opened at a branch in the *United Kingdom*:
 - (i) the Bank of England; or
 - (ii) the central bank of a member state of the *OECD*; or
 - (iii) a *bank*; or
 - (iv) a *building Society* which offers, unrestrictedly, banking services; or
 - (v) a bank which is supervised by the central bank or other banking regulator of a member state of the *OECD*; or
 - (b) if the account is opened elsewhere:
 - (i) a bank in (a); or
 - (ii) a *credit institution* established in an *EEA* state other than the *United Kingdom* and duly authorised by the relevant *Home State regulator*; or
 - (iii) a bank which is regulated in the Isle of Man or the Channel Islands; or
 - (c) a bank supervised by the South African Reserve Bank; or
 - (d) any other bank that:
 - (i) is subject to regulation by a national banking regulator;
 - (ii) is required to provide audited accounts;
 - (iii) has minimum net assets of £5million (or its equivalent in any other currency at the relevant time) and has a surplus revenue over expenditure for the last two financial years; and
 - (iv) has an annual audit report which is not materially qualified.
- approved person* means a person in relation to whom the *FSA* has given its approval under section 59 of the *Act* (Approval for particular arrangements) for the performance of a *controlled function*.
- associate* in relation to person ("A"), means:
- (a) an undertaking in the same *group* as A;
 - (b) an *appointed representative* of A or of any undertaking in the same *group* as A; and
 - (c) any other person whose business or domestic relationship with A or its *associate* might reasonably be expected to give rise to a community of interest between them which may involve a conflict of interest in dealings with third parties.
- authorised corporate director* means the *director* of an *ICVC* who is the authorised corporate director of the *ICVC* in accordance with *COLL* 6.5.3R (Appointment of an ACD) or, as the case may be, *CIS* 7.2.1R (The directors).
- authorised person* as defined in section 31 of the *Act* (*Authorised persons*), means one of the following persons authorised for the purposes of the *Act*:
- (a) a person who has a Part IV permission to carry on one or more *regulated activities*;
 - (b) an *EEA firm* qualifying for authorisation in accordance with Schedule 3 to the *Act* (*EEA*

	Passport Rights);
	(c) an <i>incoming Treaty firm</i> ;
	(d) a <i>UCITS qualifier</i> ;
	(e) an <i>ICVC</i> ;
	(f) a person who is otherwise authorised by a provision of, or made under the <i>Act</i> .
<i>authorised unit trust manager</i>	means the manager of an <i>authorised unit trust scheme</i> .
<i>authorised unit trust scheme</i>	(as defined in section 237(3) of the <i>Act</i> (Other definitions)), means a <i>unit trust scheme</i> which is authorised for the purposes of the <i>Act</i> by an authorisation order.
<i>best execution</i>	in relation to the effecting of a transaction, means the effecting of that transaction in compliance with COB 7.5.
<i>Board</i>	means the board of <i>directors</i> of <i>FSA</i> or any duly authorised committee of such board.
<i>body corporate</i>	means any body corporate, including a body corporate constituted under the law of a country or territory outside the <i>United Kingdom</i> , in accordance with section 417(1) (Definitions) of the <i>Act</i> .
<i>branch</i>	means: <ul style="list-style-type: none"> (a) in relation to a <i>credit institution</i>, a place of business which forms a legally dependent part of a <i>credit institution</i> and which carries out directly all or some of the transactions inherent in the business of <i>credit institutions</i>; (b) in relation to an <i>investment firm</i>, a place of business which is a part of an <i>investment firm</i>, not being the principal place of business, which has no separate legal personality and which provides <i>investment services</i> for which the <i>investment firm</i> has been authorised; (c) for the purposes of the <i>ISD</i>, all the places of business set up in the same <i>member state</i> by an <i>investment firm</i> with headquarters in another <i>member state</i> are to be regarded as a single <i>branch</i>.
<i>category a body</i>	means: <ul style="list-style-type: none"> (a) the government or central bank of a <i>zone a country</i>; or (b) the European Communities; or (c) the government or central bank of any other country, provided the receivable in question is denominated in that country's national currency.
<i>category b body</i>	means: <ul style="list-style-type: none"> (a) the <i>EIB</i> or a multi-lateral development bank; or (b) the regional government or local authority of a <i>zone a country</i>; or (c) an <i>investment firm</i> or <i>credit institution</i> authorised in a <i>zone a country</i>; or (d) a <i>recognised clearing house</i> or <i>exchange</i>; or (e) an <i>investment firm</i> or <i>credit institution</i> authorised in any other country, which applies a financial supervision regime at least equivalent to the <i>Capital Adequacy Directive</i>.
<i>certificates representing securities</i> or	the <i>investment</i> specified in article 80 of the <i>Regulated Activities Order</i> (Certificates representing certain securities), which is, in summary: a certificate or other instrument which confers contractual or property rights (other than rights consisting of options):
<i>certificates representing certain securities</i>	(a) in respect of any share, debenture, <i>government and public security</i> or warrant) held by a <i>person</i> other than the person on whom the rights are conferred by the certificate or instrument; and <ul style="list-style-type: none"> (b) the transfer of which may be effected without requiring the consent of that person; but excluding any certificate or other instrument which confers rights in respect of two or more <i>investments</i> issued by different persons or in respect of two or more different <i>government and</i>

	<i>public securities</i> issued by the same person.
<i>chief executive</i>	means: <ul style="list-style-type: none"> (a) (in relation to a <i>firm</i> whose principal place of business is within the United Kingdom) the person who, alone or jointly with one or more others, is responsible under the immediate authority of the <i>directors</i> for the conduct of the whole of its business; (b) (in relation to a <i>firm</i> whose principal place of business is outside the United Kingdom) the person who, alone or jointly with one or more others, is responsible for the conduct of its business within the United Kingdom.
<i>client money</i>	means, subject to the <i>Client Money Rules</i> , money of any currency which, in the course of carrying on <i>designated investment business</i> , a <i>firm</i> holds in respect of any <i>investment agreement</i> entered into, or to be entered into, with or for a client or which a <i>firm</i> treats as <i>client money</i> in accordance with the <i>Client Money Rules</i> .
<i>Client Money Rules</i>	<i>CASS 4.1 to 4.3</i> .
<i>close relative</i>	as defined in article 3(1) of the <i>Regulated Activities Order</i> (in relation to any person) means: <ul style="list-style-type: none"> (a) his spouse or civil partner; (b) his children and step-children, his parents and step-parents, his brothers and sisters and his step-brothers and step-sisters; and (c) the spouse or civil partner of any person within (b).
<i>collective investment scheme (CIS)</i>	a collective investment scheme, as defined in section 235 of the <i>Act</i> (Collective Investment Schemes), which is in summary: <ul style="list-style-type: none"> (a) any arrangements with respect to property of any description, including money, the purpose or effect of which is to enable persons taking part in the arrangements (whether by becoming owners of the property or any part of it or otherwise) to participate in or receive profits or income arising from the acquisition, holding, management or disposal of the property or sums paid out of such profits or income; and (b) which are not excluded by the Financial Services and Markets Act (Collective Investment Schemes) Order 2001 (SI 2001/1062).
<i>Companies Act</i>	means the Companies Acts 1985 to 1989 and their equivalent in Northern Ireland.
<i>company</i>	means a <i>body corporate</i> or an unincorporated association and, where the context permits, includes a partnership.
<i>competent authority</i>	means, in relation to a <i>member state</i> , an authority designated by that state to carry out the supervisory functions provided for in the <i>ISD</i> or the Second Banking Co-ordination Directive (Council Directive 89/646/EEC).
<i>compliance officer</i>	means the individual from time to time appointed by a <i>firm</i> as responsible for compliance matters.
<i>connected company and connected credit institution</i>	means, in relation to a <i>firm</i> which: <ul style="list-style-type: none"> (a) is a <i>body corporate</i>, a <i>body corporate</i> or <i>credit institution</i> satisfying any of the following conditions: <ul style="list-style-type: none"> (i) the same person is the <i>controller</i> of each <i>body corporate</i> or <i>credit institution</i>; or (ii) if a <i>group</i> of two or more persons are <i>controllers</i> of each <i>body corporate</i> or <i>credit institution</i>, the <i>group</i> either consists of the same persons or could be regarded as consisting of the same persons by treating a member of either <i>group</i> as replaced by: <ul style="list-style-type: none"> (A) that member's <i>close relative</i>; or (B) a person with whom the member is in partnership; or (C) a <i>body corporate</i> of which the member is an officer; or (iii) both <i>bodies corporate</i> are members of the same <i>group</i>; or

- (b) is not a *body corporate* or *credit institution* which is controlled:
 - (i) by the *firm*; or
 - (ii) by a partner in the *firm*; or
 - (iii) by a *close relative* or partner in the *firm* or, if the *firm* is a sole trader, by a *close relative* of the sole trader; or
 - (iv) collectively by any of the partners in the *firm* or their *close relatives*.

contractually based investment in accordance with article 3 of the *Regulated Activities Order* (Interpretation: general) means:

- (a) a *life policy*;
- (b) an option, future, contract for differences;
- (c) rights to or interests in investments falling within (a) or (b).

control in relation to the acquisition, increase or reduction of control of a *firm*, means the relationship between a person and the *firm* or other undertaking of which the person is *controller*.

controlled function means a function relating to the carrying on of a *regulated activity* by a *firm* which is specified, under section 59 of the *Act* (Approval for particular arrangements), in the Table of Controlled Functions at SUP 10.4.5.R.

controller (as defined in section 422 of the *Act* (Controller))

in relation to a *firm* or other undertaking ("A"), means a person who:

- (a) holds 10% or more of the *shares* in A; or
- (b) is able to exercise significant influence over the management of A by virtue of his shareholding in A; or
- (c) holds 10% or more of the *shares* in a parent undertaking ("P") of A; or
- (d) is able to exercise significant influence over the management of P by virtue of his shareholding in P; or
- (e) is entitled to exercise, or *control* the exercise of, 10% or more of the voting power in A; or
- (f) is able to exercise significant influence over the management of A by virtue of his voting power in A; or
- (g) is entitled to exercise, or control the exercise of, 10% or more of the voting power in P; or
- (h) is able to exercise significant influence over the management of by virtue of his voting power in P.

and in this definition

(A) "person" means:

- (a) the person; or
- (b) any of the person's *associates*; or
- (c) the person and any of his *associates*;

(B) "associate", in relation to a person (H) holding shares in an undertaking ("C") or entitled to exercise or control the exercise of voting power in relation to another undertaking ("D") means:

1. the spouse of H
2. a child or stepchild of H (if under 18);
3. the trustee of any settlement under which H has a life interest in possession (or in Scotland a life interest);
4. an undertaking of which H is a *director*;
- (e) a person who is an *employee* or *partner* of H;

- (f) if H is an undertaking:
 - (i) a *director* of H;
 - (ii) a *subsidiary* undertaking of H;
 - (iii) a *director* or *employee* of such a *subsidiary* undertaking; and
- (g) if H has with any other person an agreement or arrangement with respect to the acquisition, holding or disposal of shares or other interests in C or D or under which they undertake to act together in exercising their voting power in relation to C or D, that other person;
- (a) "settlement" includes any disposition or arrangement under which property is held on trust (or subject to a comparable obligation);
- (b) "shares" means:
 - (a) in relation to an undertaking with a share capital, allotted shares;
 - (b) in relation to an undertaking with capital but no share capital, rights to share in the capital of the undertaking;
 - (c) in relation to an undertaking without capital, interests:
 - (i) conferring any right to share in the profits, or liability to contribute to the losses, of the undertaking; or
 - (ii) giving rise to any obligation to contribute to the debts or expenses of the undertaking in the event of a winding up.

core investment service means a service listed in Section A of the Annex to the *ISD*, the text of which is set out in Schedule 2 to the *RAO*.

corporate finance business means:

- (a) *designated investment business* carried on by a *firm* with or for:
 - (i) any issuer, holder or owner of *designated investments*, if that business relates to the offer, issue, underwriting, repurchase, exchange or redemption of, or the variation of the terms of, those *investments*, or any related matter;
 - (ii) any market counterparty or *intermediate customer*, or other *body corporate*, partnership or supranational organisation, if that business relates to the manner in which, or the terms on which, or the persons by whom, any business, activities or undertakings relating to it, or any *associate*, are to be financed, structured, managed, controlled, regulated or reported upon;
 - (iii) any person in connection with:
 - (A) a proposed or actual *takeover or related operation* by or on behalf of that person, or involving investments issued by that person (being a *body corporate*), its *holding company*, *subsidiary* or *associate*; or
 - (B) a merger, de-merger, reorganisation or reconstruction involving any investments issued by that person (being a *body corporate*), its *holding company*, *subsidiary* or *associate*;
 - (iv) any shareholder or prospective shareholder of a *body corporate* established or to be established for the purpose of effecting a *takeover or related operation*, where that business is in connection with that *takeover or related operation*;
 - (v) any person who, acting as a *principal* for his own account:
 - (A) is involved in negotiations or decisions relating to the commercial, financial or strategic intentions or requirements of a business or prospective business; or
 - (B) (provided he is acting otherwise than solely in his capacity as an investor) assists the interests of another person with or for whom the *firm*, or another *authorised person* or *overseas person*, is undertaking business as specified in (a)(i),(ii),(iii) or (iv), by himself undertaking all or part of any transactions involved in such

	business;
	(vi) any person undertaking business with or for a person as specified in (a)(i), (ii), (iii), (iv) or (v) in respect of activities described in those sub-paragraphs;
	(b) <i>designated investment business</i> carried on by a <i>firm</i> as a <i>principal</i> for its own account where such <i>business</i> :
	(i) is in the course of, or arises out of, activities undertaken in accordance with (a); and
	(ii) does not involve transactions with or for, or <i>advice</i> to, any other person who is a <i>private customer</i> in respect of such business;
	(c) <i>designated investment business</i> carried on by a <i>firm</i> as <i>principal</i> for its own account if such <i>business</i> :
	(i) is in the course of, or arises out of:
	(A) the offer, issue, underwriting, repurchase, exchange or redemption of, or the variation of the terms of, shares, share warrants, <i>debentures</i> or debenture warrants issued by the <i>firm</i> , or any related matter; or
	(B) a proposed or actual <i>takeover or related operation</i> by or on behalf of the <i>firm</i> , or involving shares, share warrants, <i>debentures</i> or debenture warrants issued by the <i>firm</i> ; or
	(C) a merger, de-merger, reorganisation or reconstruction involving any shares, share warrants, <i>debentures</i> or debenture warrants issued by the <i>firm</i> ; and
	(ii) does not involve giving <i>advice on investments</i> to any person who is a <i>private customer</i> ; in this definition, “share warrants” and “debenture warrants” means any <i>warrant</i> which relates to shares in the <i>firm</i> concerned or, as the case may be, <i>debentures</i> issued by the <i>firm</i> .
<i>counterparty</i>	means any person with or for whom a <i>firm</i> carries on <i>regulated business</i> or an <i>ancillary activity</i> .
<i>counterparty risk requirement</i>	has the meaning given in Table 5.2.3(5)(c) (Counterparty risk requirement).
<i>custodian</i>	means:
	(a) an <i>approved bank</i> ;
	(b) an <i>approved depositary</i> ;
	(c) a member of a <i>recognised investment exchange</i> or <i>designated investment exchange</i> ;
	(d) a <i>firm</i> which is permitted by the <i>FSA</i> to conduct safekeeping and administration of <i>investments</i> ;
	(e) a regulated clearing <i>firm</i> ;
	(f) where it is not feasible to use a <i>custodian</i> in (a) to (e), and there are reasonable grounds to show that a person outside the <i>United Kingdom</i> , whose business includes the provision of custodial services, is able to provide such services which are appropriate to the client and in the client's best interest to use, that person.
<i>custody</i>	in relation to clients' assets, means safekeeping and administration of <i>investments</i> .
<i>customer</i>	see the meaning given to the term in the <i>Glossary</i>
<i>customer investment</i>	means an <i>investment</i> , or a document of title or a certificate or other record evidencing title to an <i>investment</i> , (other than an <i>investment</i> falling within articles 83, 84 and 85 of the <i>RAO</i>) which is legally or beneficially owned by a <i>customer</i> of a <i>firm</i> .
<i>customer transaction</i>	does not include an <i>own account transaction</i> .
<i>debenture</i>	means the investment specified in article 77 of the <i>Regulated Activities Order</i> (Instruments creating or acknowledging indebtedness), which is in summary: any of the following which are not <i>government and public securities</i> :

- (a) debentures;
- (b) debenture stock;
- (c) loan stock;
- (d) bonds;
- (e) certificates of deposit;
- (f) any other instruments creating or acknowledging indebtedness.

deposit

means the investment, specified in article 74 and defined in articles 5(2) and 5(3) of the *Regulated Activities Order*, which is, in summary: a sum of money (other than one excluded by any of articles 6 to 9 of the *Regulated Activities Order*) paid on terms:

- (a) under which it will be repaid, with or without interest or a premium, and either on demand or at a time or in circumstances agreed by or on behalf of the person making the payment and the person receiving it; and
- (b) which are not referable to the provision of property (other than currency) or services or the giving of security;

in this definition, money is paid on terms which are referable to the provision of property or services or the giving of security if, and only if:

- (a) it is paid by way of advance or part payment under a contract for the sale, hire or other provision of property or services, and is repayable only in the event that the property or services is or are not in fact sold, hired or otherwise provided; or
- (b) it is paid by way of security for the performance of a contract or by way of security in respect of loss which may result from the non-performance of a contract; or
- (c) without prejudice to (b), it is paid by way of security for the delivery up or return of any property, whether in a particular state of repair or otherwise.

depository

- (1) (in relation to an *ICVC*) the *person* to whom is entrusted the safekeeping of all of the *scheme property* of the *ICVC* and who has been appointed for this purpose in accordance with regulation 5 (Safekeeping of scheme property by depository) of and Schedule 1 (Depositaries) to the *OEIC Regulations*.
- (2) (in relation to an *AUT*) the *trustee*.
- (3) (in relation to any other *unit trust scheme*) the *person* holding the property of the *scheme* on trust for the *participants*.
- (4) (in relation to any other *collective investment scheme*) any *person* to whom the property subject to the *scheme* is entrusted for safekeeping.

designated investment

see the meaning given to the term in the *Glossary*

designated investment business

see the meaning given to the term in the *Glossary*

<i>designated investment exchange</i>	see the meaning given to the term in the <i>Glossary</i>
<i>director</i>	<p>means, in relation to the following (whether constituted in the <i>United Kingdom</i> or under the law of a country or territory outside it):</p> <p>(a) an unincorporated association;</p> <p>(b) a <i>body corporate</i>;</p> <p>any person appointed to direct its affairs, including a person who is a member of its governing body and (in accordance with section 417(1) of the Act):</p> <p>(i) a person occupying in relation to it the position of a director (by whatever name called) and</p> <p>(ii) a person in accordance with whose directions or instructions (not being advice given in a professional capacity) the directors of that body are accustomed to act.</p>
<i>EEA</i>	means the European Economic Area.
<i>EEA parent</i>	means a <i>firm's</i> direct or indirect <i>parent</i> which has its head office in the <i>EEA</i> .
<i>EEA right</i>	<p>(in accordance with paragraph 7 of Schedule 3 to the Act (EEA Passport Rights)): means the entitlement of a person to establish a <i>branch</i>, or provide services in an <i>EEA State</i> other than that in which he has his head office –</p> <p>(a) in accordance with the Treaty as applied in the <i>EEA</i>; and</p> <p>(b) subject to the conditions of the relevant Single Market Directives.</p>
<i>EEA State</i>	see definition of <i>EEA State</i> in the <i>Glossary</i>
<i>EIB</i>	means the European Investment Bank.
<i>European investment firm</i>	<p>means an <i>incoming EEA firm</i>.</p> <p>Note: A <i>European investment firm</i> is not necessarily a <i>firm</i> for the purposes of the <i>rules</i>.</p>
<i>exempt exposure</i>	<p>means an exposure:</p> <p>(a) to or guaranteed by a central government or central bank of a <i>zone a country</i>; or</p> <p>(b) to or guaranteed by the European Communities; or</p> <p>(c) to a central government or central bank of a <i>zone b country</i> denominated in the national currency of the third party; or</p> <p>(d) secured by securities issued by a central government or central bank of a <i>zone a country</i>, or by the European Communities; or</p> <p>(e) secured by cash deposited with the <i>firm</i> or its <i>connected credit institution</i>; or</p> <p>(f) secured by certificates of deposit issued by the <i>firm</i> or its <i>connected credit institution</i> and deposited with one of them; or</p> <p>(g) to a <i>connected company</i> provided that the <i>group</i> is supervised on a consolidated basis in accordance with the <i>Banking Consolidation Directive</i> and the consolidation requirements of the <i>Capital Adequacy Directive</i>; or</p> <p>(h) with a maturity of one year or less to a <i>credit institution</i>, <i>investment firm</i>, <i>recognised third country investment firm</i>, and <i>recognised clearing houses</i> and <i>recognised investment exchanges</i> in financial instruments, not constituting their <i>financial resources</i>; or</p> <p>(i) connected with foreign exchange transactions, incurred in the ordinary course of settlement during the 48 hours following payment; or</p> <p>(j) in connection with transactions for the purchase or sale of securities incurred in the ordinary course of settlement during the five working days following payment or delivery of the securities; or</p> <p>(k) which is a bill of trade, with a maturity of less than one year, accepted by a <i>credit institution</i>;</p>

or

- (l) secured by marketable securities provided that such collateral exceeds the market value of the *exposure* by 150 per cent in the case of transactions relating to shares and by 50 per cent in relation to debt securities issued by a *credit institution*, a *member state* regional or local authority or a *multilateral development bank*.

exempted person or *exempt person* (as defined in section 417(1) of the *Act* (Definitions)) (in relation to a *regulated activity*), means: a person who is exempt from the *general prohibition* in respect of that activity as a result of:

- (a) the *Exemption Order*; or
(b) being an *appointed representative*; or
(c) section 285(2) or (3) of the *Act* (Exemption for recognised investment exchanges and clearing houses).

Exemption Order means The Financial Services and Markets Act 2000 (Exemption) Order 2001 (SI 2001/1201).

expenditure based requirement means the requirement calculated in accordance with Table 5.2.3(5)(a) (Expenditure based requirement).

exposure means any of the following:

- (a) the current market value of any *investment* held by the *firm*, or any underwriting commitment entered into by the *firm* where its own capital is at risk;
(b) the amount of any exposure to a *counterparty*;
(c) the value of all other assets and off-balance sheet items (at market or book value, whichever is higher) constituting claims on third parties, excluding any illiquid asset which is deducted in full in the calculation of *liquid capital*.

finance officer means the most senior individual from time to time directly responsible for the *firm's* finances and for compliance with the requirements of the Supervision Manual.

financial holding company means a *financial institution* the *subsidiary undertakings* of which are either exclusively or mainly *credit institutions*, *investment firms* and *financial institutions*, one of which at least is a *credit institution* or an *investment firm*.

financial resources has the meaning given in rule 5.2.1(3) (Financial resources).

financial resources requirement has the meaning given in rule 5.2.3(1) (a) to (c) (Determination of requirement).

financial resources rules has the meaning given in rules 5.2.1 to 5.2.7.

financial return means *annual financial return*, *quarterly financial return* or *monthly financial return* as the case may be.

firm means an *authorised person*.

foreign exchange position has the meaning given in Table 5.2.3(5)(d) (Foreign exchange requirement).

friendly society see the meaning given to the term in the *Glossary*.

FSA means the Financial Services Authority.

funds under management (1) *collective investment schemes* other than *OEICs* managed by the *firm* including *schemes* where it has delegated the management function but excluding *schemes* that it is *managing* as delegate; and
(2) *OEICs* for which the *firm* is the designated management company.

general prohibition the prohibition imposed by section 19 of the *Act* (The general prohibition) which states that no *person* may carry on a *regulated activity* in the *United Kingdom*, or purport to do so, unless he is:

	(a) an <i>authorised person</i> ; or
	(b) an <i>exempt person</i> .
<i>Glossary</i>	means the glossary of defined terms which applies for other parts of the Handbook as amended from time to time.
<i>government and public security</i>	the <i>investment</i> , specified in article 78 of the <i>Regulated Activities Order (Government and public securities)</i> which is in summary: a loan stock, bond or other instrument creating or acknowledging indebtedness, issued by or on behalf of any of the following: <ul style="list-style-type: none"> (a) the government of the <i>United Kingdom</i>; or (b) the Scottish Administration; or (c) the Executive Committee of the Northern Ireland Assembly; or (d) the National Assembly of Wales; or (e) the government of any country or territory outside the <i>United Kingdom</i>; or (f) a local authority in the <i>United Kingdom</i> or elsewhere; or (g) a body the members of which comprise: <ul style="list-style-type: none"> (i) states including the <i>United Kingdom</i> or another <i>EEA State</i>; or (ii) bodies whose members comprise states including the <i>United Kingdom</i> or another <i>EEA State</i>; but excluding: <ul style="list-style-type: none"> (a) the instruments specified in article 77(2)(a) to (d) of the <i>Regulated Activities Order</i>; (b) any instrument creating or acknowledging indebtedness in respect of: <ul style="list-style-type: none"> (i) money received by the Director of Savings as <i>deposits</i> or otherwise in connection with the business of the National Savings Bank; or (ii) money raised under the National Loans Act 1968 under the auspices of the Director of Savings or treated as so raised under section 11(3) of the National Debt Act 1972.
<i>group</i>	see the meaning given to the term in the <i>Glossary</i>
<i>Group of connected counterparties</i>	means: <ul style="list-style-type: none"> (a) two or more natural or legal persons who constitute a single risk because one of them, directly or indirectly, has <i>control</i> over the other or others; or (b) two or more natural or legal persons between whom there is no relationship of <i>control</i> as in (a) but who are to be regarded as constituting a single risk because they are so interconnected that, if one of them were to exercise financial problems, the other or all of the others would be likely to encounter difficulties in performing its or their obligations.
<i>holding company</i>	(as defined in sub-section 736(1) of the Companies Act 1985) (in relation to another body corporate ("S")), means a body corporate which: <ul style="list-style-type: none"> (a) holds a majority of the voting rights in S; or (b) is a member of S and has the right to appoint or remove a majority of its board of directors; or (c) is a member of S and controls alone, under an agreement with other shareholders and members, a majority of the voting rights in S.
<i>Home State</i>	means: <ul style="list-style-type: none"> (a) if the <i>investment firm</i> is a natural person, the <i>EEA State</i> in which its head office is situated; (b) if the <i>investment firm</i> is a legal person, the <i>EEA State</i> in which the registered office is situated or, if under its national law it has no registered office, the <i>EEA State</i> in which its head office is situated.
<i>Home State regulator</i>	means: <ul style="list-style-type: none"> (a) (in relation to an <i>EEA firm</i>) (as defined in paragraph 9 of Schedule 3 to the <i>Act</i> (EEA Passport

Rights)) the *competent authority* (under the relevant *Single Market Directive*) of an *EEA State* (other than the *United Kingdom*) in relation to the *EEA firm* concerned.

- (b) (in relation to a *UK firm*) the *FSA*.
- (c) (in relation to a *Treaty firm*) (as defined in paragraph 1 of Schedule 4 to the *Act* (Treaty Rights)) the competent authority of the *firm's Home State* for the purpose of its *Home State* authorisation.

<i>Host State</i>	means the <i>EEA State</i> in which an <i>EEA firm</i> , a <i>UK firm</i> or a <i>Treaty firm</i> is exercising rights to establish a <i>branch</i> or provide cross-border services.
<i>IADB</i>	means the Inter-American Development Bank.
<i>IBRD</i>	means the International Bank for Reconstruction and Development.
<i>ICVC</i>	means a UK corporate fund which is an ICVC, as defined in the <i>Glossary</i> .
<i>(investment company with variable capital)</i>	
<i>IFC</i>	means the International Finance Corporation.
<i>incoming EEA firm</i>	see the meaning given to the term in the <i>Glossary</i>
<i>initial capital</i>	(in relation to a <i>UCITS management company</i>) means capital calculated in accordance with Table 7.3.1R (Method of calculation of financial resources) composed of the specified items set out in that Table.
<i>investigation</i>	means an investigation authorised pursuant to the Enforcement Guide.
<i>investment</i>	means a <i>designated investment</i> .
<i>investment agreement</i>	means any agreement the making or performance of which by either party constitutes a <i>regulated activity</i> , but disregarding the exclusions in Part II of the <i>Regulated Activities Order</i> .
<i>investment business</i>	means <i>designated investment business</i> .
<i>investment firm</i>	has the meaning given to <i>investment firm</i> in the main <i>Glossary</i> except that it excludes persons to which the <i>ISD</i> does not apply as a result of article 2.2 of the <i>ISD</i> . Note: An <i>investment firm</i> is not necessarily a <i>firm</i> for the purposes of the rules.
<i>investment management firm</i>	see the meaning given to the term in the <i>Glossary</i>
<i>investment manager</i>	means a person who, acting only on behalf of a <i>customer</i> , either: <ul style="list-style-type: none">(a) manages an account or portfolio in the exercise of discretion; or(b) has accepted responsibility on a continuing basis for advising on the composition of the account or portfolio.
<i>investment services</i>	means activities undertaken in the course of carrying on <i>designated investment business</i> or undertaken as an <i>ISA manager</i> .
<i>investment trust</i>	means a <i>company</i> listed in the <i>United Kingdom</i> or another <i>EEA State</i> which is: <ul style="list-style-type: none">(a) approved by the Commissioners for HM Revenue and Customs under section 842 of the Income and Corporation Taxes Act 1988 (or, in the case of a newly formed <i>company</i>, has declared its intention to conduct its affairs so as to obtain such approval); or(b) resident in another <i>member state</i> and would qualify for such approval if resident and listed in the <i>United Kingdom</i>.
<i>investment trust savings scheme</i>	means a dealing service (whether or not held within a <i>pension contract</i>) dedicated to the securities of a particular <i>investment trust</i> or of <i>investment trusts</i> within a particular <i>marketing group</i> , and references to an <i>investment trust savings scheme</i> include references to securities to be acquired through that scheme.

<i>ISA</i>	means an individual savings account within the meaning of the Individual Savings Account Regulations 1998 (SI 1998/1870).
<i>ISA cash deposit</i>	means a cash deposit within Regulation 8 of the Individual Savings Account Regulations 1998 (SI 1998/1870) which is held within a cash component ISA.
<i>ISA manager</i>	means a person who is approved by the Commissioners for HM Revenue and Customs for the purposes of the Individual Savings Account Regulations 1998 (SI 1998/1870) as an account manager.
<i>ISD or Investment Services Directive</i>	means the Council Directive of 10 May 1993 on investment services in the securities field (No. 93/22/EEC).
<i>ISD firm</i>	means a <i>firm</i> which is a <i>UK authorised investment firm</i> .
<i>ISD investment services</i>	means <i>core investment services</i> and <i>non-core investment services</i> .
<i>large exposure</i>	Means any exposure to a <i>counterparty</i> or group of <i>connected counterparties</i> which exceeds 10 per cent of a <i>firm's own funds</i>
<i>life policy</i>	(in accordance with the definition of "qualifying contract of insurance" in article 3(1) of the <i>Regulated Activities Order</i>) means a <i>long-term insurance contract</i> (which includes a pension policy) other than a reinsurance contract and a pure protection contract.
<i>liquid capital</i>	has the meaning given in rule 5.2.2(1) (Calculation of own funds and liquid capital).
<i>liquid capital requirement</i>	has the meaning given in rule 5.2.3(4) (a) to (c) (Liquid capital requirement).
<i>long term insurance contract</i>	means, in accordance with article 3(1) of the <i>Regulated Activities Order</i> (Interpretation: general), any contract of insurance within Part II of Schedule 1 to the <i>Regulated Activities Order</i> (Contracts of long term insurance), namely: <ul style="list-style-type: none"> (a) Life and Annuity (paragraph I); (b) Marriage or the formation of a civil partnership and birth (paragraph II); (c) Linked long term (paragraph III); (d) Permanent health (paragraph IV); (e) Tontines (paragraph V); (f) Capital redemption (paragraph VI); (g) Pension fund management (paragraph VII) (h) Collective insurance etc (paragraph VIII); (i) Social insurance (paragraph IX).
<i>marketable investment</i>	means: <ul style="list-style-type: none"> (a) an <i>investment</i> which is traded on or under the rules of an exchange; (b) a debt instrument which may be transferred without the consent of the issuer or any other person (including a collateralised mortgage obligation); (c) a commodity; (d) a <i>warrant</i>, option, future or other instrument which entitles the holder to subscribe for or acquire: <ul style="list-style-type: none"> (i) an <i>investment</i> or commodity in (a) to (c); or (ii) any currency; or

	(iii) any combination of (i) and (ii);
	(e) a contract for differences (including interest rate and currency swaps) relating to fluctuations in:
	(i) the value or price of an <i>investment</i> or commodity in (a) to (d); or
	(ii) any currency; or
	(iii) the rate of interest in any currency or any index of such rates; or
	(iv) the level of any index which is derived from the prices of an <i>investment</i> or commodity in (a) to (c); or
	(v) any combination of (i) to (iv);
	(f) <i>warrants</i> , options, futures or other instruments entitling the holder to obtain the rights of those contracts in (d) or (e);
	(g) a <i>unit</i> in a <i>regulated collective investment scheme</i> .
<i>market maker</i>	see the meaning given to the term in the <i>Glossary</i>
<i>marketing group</i>	means a group of persons:
	(a) who are allied together (either formally or informally) for the purposes of marketing <i>packaged products</i> of the group; and
	(b) each of whom, if it holds itself out in the UK as marketing any <i>packaged products</i> to <i>private customers</i> , does so only as an <i>investment manager</i> or in relation to those of the <i>marketing group</i> .
<i>member state</i>	means a member state of the <i>EEA</i> .
<i>monthly financial return</i>	means the return referred to in the Supervision Manual.
<i>non-core investment service</i>	means a service listed in Section C of the Annex to the ISD.
<i>non-private customer</i>	means an <i>intermediate customer</i> .
<i>operator</i>	means:
	(a) (in relation to an <i>AUT</i>) the <i>manager</i> ;
	(b) (in relation to an <i>ICVC</i>) that <i>company</i> or, if applicable, the <i>authorised corporate director</i> ;
	(c) (in relation to any other <i>collective investment scheme</i> that is a <i>unit trust scheme</i> with a separate <i>trustee</i>) any person who, under the trust deed establishing the <i>scheme</i> , is responsible for the management of the property held for or within the <i>scheme</i> ;
	(d) (in relation to any other <i>collective investment scheme</i> that is an <i>open-ended investment company</i>) that <i>company</i> or, if applicable any <i>person</i> who, under the constitution or founding arrangements of the <i>scheme</i> , is responsible for the management of the property held for or within the <i>scheme</i> ;
	(e) (in relation to an <i>investment trust savings scheme</i>) any <i>person</i> appointed, by those responsible for managing the property of the <i>investment trust</i> , to manage the <i>investment trust savings scheme</i> .
<i>OPS or occupational pension scheme</i>	means any scheme or arrangement which is comprised in one or more instruments or agreements and which has, or is capable of having, effect in relation to one or more descriptions or categories of employment so as to provide benefits, in the form of pensions or otherwise, payable on termination of service, or on death or retirement, to or respect of earners with qualifying service in an employment of any such description or category.
<i>OPS activity</i>	see the meaning given to the term in the <i>Glossary</i>

OPS firm

means:

- (a) a *firm* which:
 - (i) carries on *OPS activity* but not with a view to profit;
and
 - (ii) is one or more of the following:
 - (A) a trustee of the *occupational pension scheme* in question;
 - (B) a *company* owned by the trustees of the *occupational pension scheme* in question;
 - (C) a *company* which is:
 - (I) an employer in relation to the *occupational pension scheme* in question in respect of its employees or former employees or their dependants; or
 - (II) a *company* within the *group* which includes an employer within (I); or
 - (III) an administering authority subject to the Local Government Superannuation Regulations 1986; or
- (b) a *firm* which:
 - (i) has satisfied the requirements set out in (a) at any time during the past 12 *months*; but
 - (ii) is no longer able to comply with those requirements because of a change in the control or ownership of the employer referred to in (a)(ii) during that period.

ordinary business investor means:

- (a) a government, local authority or international organisation;
- (b) a *company* or partnership which satisfies (or which has satisfied at any time during the previous two years) any of the following size requirements:
 - (i) that it is a *body corporate* which has more than 20 members (or is the *subsidiary* of a company which has more than 20 members) and it (or any of its *holding companies* or *subsidiaries*) has a called up share capital or net assets of £500,000 or more; or
 - (ii) that it is a *body corporate* and it (or any of its *holding companies* or *subsidiaries*) has a called up share capital or net assets of £5 million or more; or
 - (iii) if it is not a *body corporate*, it has net assets of £5 million or more (calculated in the case of a limited partnership, without deducting loans owing to any of the partners); or
- (c) a *trustee* of a trust which satisfies either of the following size requirements:
 - (i) that the aggregate value of the cash and *investments* which form part of the trust's assets (before deducting the amount of its liabilities) is £10 million or more; or
 - (ii) that that aggregate value has been £10 million or more at any time during the previous two years; or
- (d) any *authorised person* or *overseas person* which does not already qualify under (a), (b) or (c) above;

and in this definition *government, local authority or international organisation* means:

- (a) the government of the *United Kingdom*, of Northern Ireland, or of any country or territory outside the *United Kingdom*;
- (b) a local authority in the *United Kingdom* or Anywhere; or
- (c) an international organisation the members of which include the *United Kingdom or another EEA State*.

otc derivative

means interest rate and foreign exchange contracts covered by Annex III to the previous version of the *Banking Consolidation Directive* (i.e. Directive (2000/12/EC) and off balance sheet contracts based on equities which are not traded on a *recognised* or *designated investment exchange* or other exchange where they are subject to daily margin requirements, excluding any

	foreign exchange contract with an original maturity of 14 calendar days or less.
<i>other assets requirement</i>	has the meaning given in Table 5.2.3(5) (e) (Other assets requirement).
<i>overseas person</i>	see the meaning given to the term in the <i>Glossary</i>
<i>own account transaction</i>	means a transaction executed by the <i>firm</i> for its own benefit or for the benefit of its <i>associate</i> .
<i>own funds</i>	has the meaning given in rule 5.2.2(1) (Calculation of own funds and liquid capital).
<i>own funds requirement</i>	has the meaning given in rule 5.2.3(3) (a) and (b) (Own funds requirement).
<i>own funds return</i>	see paragraph 2(b) of Part II of Table 5.2.3(3)(b) (Own funds requirement). Note: Copies of this return are available on request from <i>FSA</i> (Own funds requirement).
<i>own funds transitional provisions</i>	means the provisions of Part II of Table 5.2.3(3)(b) (Own funds requirement).
<i>packaged product</i>	means: <ul style="list-style-type: none"> (a) a <i>life policy</i>; (b) a unit in a <i>regulated collective investment scheme</i>; (c) an interest in an <i>investment trust savings scheme</i>; (d) a stakeholder pension scheme; whether or not (in the case of (a), (b) or (c)) held within a <i>PEP</i> or an <i>ISA</i> .
<i>parent</i>	means any parent undertaking as defined in section 258 of the Companies Act 1985 and any undertaking which effectively exercises a dominant influence over another undertaking.
<i>partially exempt exposures</i>	means an <i>exposure</i> which may be reduced: <ul style="list-style-type: none"> (a) by 50 per cent in the case of low or medium risk off balance sheet items including documentary credits in which an underlying shipment acts as collateral, undrawn credit facilities with an original maturity of up to and including one year which may be cancelled unconditionally at any time without notice including agreements to lend, purchase securities, provide guarantees or acceptance facilities; (b) by 80 per cent in the case of <i>exposures</i> to or guaranteed by EC regional or local authorities; (c) for an <i>exposure</i> in a financial instrument to a <i>credit institution</i>, <i>investment firm</i>, <i>recognised third country investment firm</i>, and a <i>recognised clearing house</i> or <i>recognised investment exchange</i>, either <ul style="list-style-type: none"> (i) by 80 per cent if it has a maturity of more than one but not more than three years; or (ii) by 50 per cent (for marketable debt instruments only – 100 per cent otherwise) if it has a maturity of more than three years.
<i>participation</i>	means a holding either direct or indirect of 20% or more of the voting rights or capital of another undertaking.
<i>pension contract</i>	means a contract under which rights to benefits are obtained by the making of contributions to an <i>occupational pension scheme</i> or to a personal pension scheme, where the contributions are paid to a <i>regulated collective investment scheme</i> .
<i>PEP</i>	means a Personal Equity Plan within the meaning of the Personal Equity Plan Regulations 1989 (SI 1989/469)
<i>permission</i>	(in accordance with section 20(1) of the <i>Act</i>) permission: <ul style="list-style-type: none"> (a) given by the <i>FSA</i> under Part IV of the <i>Act</i> (Permission to carry on regulated activities); or

	(b) resulting from any other provision of the <i>Act</i> ; to carry on <i>regulated activities</i> in the <i>United Kingdom</i> .
<i>permitted business</i>	means <i>regulated activity</i> which a <i>firm</i> has <i>permission</i> to carry on.
<i>permitted third party or PTP</i>	means a third party who is: (a) an <i>authorised person</i> ; or (b) an <i>exempt</i> person for whom an <i>authorised person</i> is accepting responsibility; or (c) a person lawfully carrying on a <i>regulated activity</i> in another <i>EEA State</i> .
<i>plan investment</i>	means an <i>investment</i> included in a <i>PEP</i> or in any <i>ISA</i> component.
<i>position risk requirement</i>	has the meaning given in Table 5.2.3(5)(b) (Position risk requirement).
<i>powers of intervention</i>	means <i>FSA</i> 's powers to impose prohibitions and restrictions in accordance with the <i>Act</i> .
<i>prescribed subordinated loan agreement</i>	means the subordinated loan agreement prescribed by the <i>FSA</i> for the purposes of rule 5.2.5(4).
<i>principal</i>	means a person acting on his own account.
<i>qualifying amount</i>	has the meaning given in the Supervision Manual.
<i>qualifying capital instrument</i>	means that part of a <i>firm</i> 's capital which is a security of indeterminate duration, or other instrument, that fulfils the following conditions: (a) it may not be reimbursed on the bearer's initiative or without the prior agreement of <i>FSA</i> ; (b) the debt agreement must provide for the <i>firm</i> to have the option of deferring the payment of interest on the debt; (c) the lender's claims on the <i>firm</i> must be wholly subordinated to those of all non-subordinated creditors; (d) the documents governing the issue of the securities must provide for debt and unpaid interest to be such as to absorb losses, whilst leaving the <i>firm</i> in a position to continue trading; and (e) only fully paid-up amounts shall be taken into account.
<i>qualifying capital item</i>	means that part of a <i>firm</i> 's capital which has the following characteristics: (a) it is freely available to the <i>firm</i> to cover normal banking or other risks where revenue or capital losses have not yet been identified; (b) its existence is disclosed in internal accounting records; and (c) its amount is determined by the management of the <i>firm</i> and verified by independent auditors, and is made known to, and is monitored by, <i>FSA</i> . Note: Verification by internal auditors will suffice until such time as EU provisions making external auditing mandatory have been implemented.
<i>qualifying property</i>	has the meaning given in rule 5.2.6(1) (Qualifying property and qualifying amount defined).
<i>qualifying subordinated loan</i>	has the meaning given in rule 5.2.5 (1) to (7) (Qualifying subordinated loans).
<i>qualifying undertaking</i>	has the meaning given in rule 5.2.6(3) (Qualifying undertakings).
<i>quarterly financial return</i>	means the return referred to in the Supervision Manual.

<i>RAO or Regulated Activities Order</i>	means the Financial Services and Markets Act (Regulated Activities) Order 2001 (SI 2001/544).
<i>readily realisable investment</i>	means a unit in a <i>regulated collective investment scheme</i> , a <i>life policy</i> or any <i>marketable investment</i> other than one which is traded on or under the rules of a <i>recognised</i> or <i>designated investment exchange</i> so irregularly or infrequently: <ul style="list-style-type: none"> (a) that it cannot be certain that a price for that <i>investment</i> will be quoted at all times; or (b) that it may be difficult to effect transactions at any price which may be quoted.
<i>recognised clearing house</i>	means a clearing house which is declared by a recognition order made under section 290 or 292 of the <i>Act</i> for the time being in force to be a recognised clearing house.
<i>recognised investment exchange</i>	means an investment exchange which is declared by a recognition order made under section 290 or 292 of the <i>Act</i> for the time being in force to be a recognised investment exchange.
<i>recognised overseas clearing house</i>	means an <i>overseas clearing house</i> which is declared by a recognition order made under section 290 or 292 of the <i>Act</i> for the time being in force to be a <i>recognised clearing house</i> .
<i>recognised overseas investment exchange</i>	means an <i>overseas investment exchange</i> which is declared by a recognition order made under section 290 or 292 of the <i>Act</i> for the time being in force to be a <i>recognised investment exchange</i> .
<i>recognised scheme</i>	means a scheme recognised under: <ul style="list-style-type: none"> (a) section 264 of the <i>Act</i> (Schemes constituted in other EEA States); (b) section 270 of the <i>Act</i> (Schemes authorised in designated countries or territories); or (c) section 272 of the <i>Act</i> (Individually recognised overseas schemes).
<i>recognised third country investment firm</i>	means an <i>investment firm</i> which is authorised in a country other than a <i>member state</i> and which is subject to and complies with prudential rules equivalent to the requirements of the <i>Capital Adequacy Directive</i> . <p>Note: A <i>recognised third country investment firm</i> is not necessarily a <i>firm</i> for the purposes of the <i>rules</i>.</p> <p>Note: A list of the non-EEA regulators which are approved by <i>FSA</i> for the purposes of recognising <i>recognised third country investment firms</i> under the <i>Capital Adequacy Directive</i> is available on request from the <i>FSA</i>.</p>
<i>redemption</i>	in relation to units in an <i>ICVC</i> or an <i>authorised unit trust scheme</i> , means the purchase of them from their holder by the authorised fund manager acting as a <i>principal</i> .
<i>registered individual</i>	means an <i>approved person</i> .
<i>registrable activity</i>	in relation to a <i>firm</i> , means any one of the following: <ul style="list-style-type: none"> (a) holding the post of <i>director</i> or <i>chief executive</i>; (b) acting as an <i>investment manager</i> in the course of the <i>permitted business</i> of the <i>firm</i>; (c) acting in a senior capacity with responsibility either alone or jointly with one or more other individuals for the management, supervision and control of a part of the <i>firm's permitted business</i> (including the <i>compliance officer</i> and the <i>finance officer</i>); (d) procuring or endeavoring to procure other persons to enter into <i>investment agreements</i>, or giving advice to persons with whom he deals about entering into <i>investment agreements</i> or exercising rights conferred by <i>investments</i>, in the course of the <i>permitted business</i> of the <i>firm</i>; (e) committing the <i>firm</i> or its <i>customers</i> in market dealings or in transactions in <i>securities</i> or in other <i>investments</i> in the course of the <i>firm's permitted business</i>.

<i>registrar</i>	means, in relation to any friendly society or to any self-regulating organisation for friendly societies which has applied for, or been granted, a recognition order made by him, the Chief Registrar of Friendly Societies or, as the case may be, the Registrar of Friendly Societies for Northern Ireland.
<i>regulated activity</i>	see the meaning given to the term in the <i>Glossary</i>
<i>regulated business</i>	means <i>designated investment business</i> .
<i>regulated collective investment scheme</i>	means: <ul style="list-style-type: none"> (a) an <i>ICVC</i>; (b) an <i>authorised unit trust scheme</i>; or (c) a <i>recognised scheme</i>; <p>whether or not the units are held within a <i>PEP, ISA, or pension contract</i>.</p>
<i>regulated friendly society</i>	means, as respects <i>investment business</i> carried on for or in connection with any of the purposes mentioned in Schedule 1 to the Friendly Societies Act 1974, or, as the case may be, to the Friendly Societies Act (Northern Ireland) 1970, means a society which is a friendly society within the meaning of section 7(1)(a) of the Friendly Societies Act 1974 and is registered within the meaning of that Act or is a friendly society within the meaning of section 1(1)(a) of the Friendly Societies Act (Northern Ireland) 1970 and is registered or deemed to be registered under that Act; and <ul style="list-style-type: none"> (a) under its rules, has its registered office at a place situated in Great Britain or, as the case may be, Northern Ireland; and (b) carries on <i>investment business</i> in the UK.
<i>relevant foreign exchange items</i>	means: <ul style="list-style-type: none"> (a) all assets less liabilities, including accrued interest, denominated in the currency (all investments at market or realisable value); (b) any currency future, at the nominal value of the contract; (c) any forward contract for the purchase or sale of the currency, at the contract value, including any future exchange of principal associated with currency swaps; (d) any foreign currency options at the net delta (or delta-based) equivalent of the total book of such options; (e) any non-currency option, at market value; (f) any irrevocable guarantee; (g) any other off-balance sheet commitment to purchase or sell an asset denominated in that currency.
<i>reporting currency</i>	means the currency in which the <i>firm's</i> books of account are maintained.
<i>rule or rules</i>	in accordance with section 417(1) of the <i>Act</i> (Definitions), means a rule made by the <i>FSA</i> under the <i>Act</i> , including: <ul style="list-style-type: none"> (a) a Principle; and (b) an evidential provision.
<i>scheme</i>	means a <i>collective investment scheme</i> .
<i>securities</i>	means <i>shares, debentures, government and public securities, warrants and certificates representing securities</i> .
<i>small business investor</i>	means: <ul style="list-style-type: none"> (a) a <i>company</i> or partnership; or

(b) a *trustee* acting for a trust;

which does not satisfy a size requirement enabling the *company*, partnership or *trustee* to be treated as an *ordinary business investor*.

sole trader

means an individual who is a *firm*.

specified trustee business

1. means any *investment business* carried on in the UK by a *trustee firm*, but excluding each of the following activities:

(a) **Dealing or arranging deals in *investments***

- (i) where the deal is transacted or arranged by a *trustee firm* with or through a *PTP*; or
- (ii) where the dealing or arranging is done in the course of, or is incidental to, an activity of management falling within paragraph (b) below; or
- (iii) where the trust is a *unit trust scheme* and the deal is or the arrangements are made with a view to either an issue or sale of units in such a *scheme* to, or a redemption or repurchase or conversion of such units or a dealing in investments for such a *scheme* carried out by with or through, the *operator* or on the instructions of the *operator*; or
- (iv) where the *trustee firm*, being a bare trustee (or, in Scotland, a nominee) holding *investments* for another person, is acting on that person's instructions; or
- (v) where any arrangements do not or would not bring about the transaction in question.

(b) **Managing Investments**

- (i) where the *trustee firm* has no general authority to effect transactions in *investments* at discretion; or
- (ii) if and to the extent that all day-to-day decisions in relation to the management of the *investments* or any discrete part of the *investments* are or are to be taken by a *PTP*; or
- (iii) if and to the extent that investment decisions in relation to the *investments* or any discrete part of the *investments* are or are to be taken substantially in accordance with the advice given by a *PTP*; or
- (iv) where the *trustee firm* is a personal representative or executor and is acting in that capacity; or
- (v) where the trust is a *unit trust scheme* and all day-to-day investment decisions in the carrying on of that activity are or are to be taken by the *operator* of the *scheme*.

(c) **Investment advice**

- (i) where the relevant advice:
 - (A) does not recommend the entry into any investment transaction or the exercise of any right conferred by any *investment* to acquire, dispose of, underwrite or convert such an *investment*; and
 - (B) is accompanied by a recommendation that independent advice be obtained; or
- (ii) if and to the extent that the relevant advice is in substance

the advice of a *PTP*; or

(iii) where the relevant advice is given by the *trustee firm* acting in the capacity of personal representative or executor.

(d) **Establishing, operating or winding up a collective investment scheme including acting as trustee of an authorised unit trust scheme** but only to the extent that such activities do not otherwise constitute *specified trustee business*.

(e) **Any trustee activity undertaken as trustee of an issue of debentures or government or public securities**

(i) where the issue is made by a company listed on a *recognised investment exchange* or on a *designated investment exchange* (or by a wholly-owned subsidiary of such a company); or

(ii) where the issue is listed or traded either on a *recognised investment exchange* or on a *designated investment exchange* or on the Société de la Bourse de Luxembourg; or

(iii) where the issue is made by a government, local authority or international organisation; or

(iv) where the aggregate amounts issued (pursuant to the trust deed or any deed supplemental thereto and ignoring any amounts redeemed, repurchased or converted) exceed the sum of £10,000,000.

2. For the purpose of this definition of “*specified trustee business*”:

(a) a transaction is entered into through a person if that person:

(i) enters into it as agent; or

(ii) arranges for it to be entered into as principal or agent by another person and the arrangements are such that they bring about the transaction in question;

(b) **investment transaction** means a transaction to purchase, sell, subscribe for or underwrite a particular investment and “investment decision” means a decision relating to an investment transaction;

(c) **debentures** means any securities falling within article 77 of the *RAO*;

(d) **government or public securities** means any securities falling within article 78) of the *RAO*;

(e) *government, local authority or international organisation* means:

(i) the government of the *United Kingdom*, of Northern Ireland, or of any country or territory outside the United Kingdom;

(ii) a local authority in the *United Kingdom* or Anywhere; or

(iii) an international organisation the members of which include the *United Kingdom or another EEA State*.

(f) in determining the size of an issue of debentures or government or public securities made in a currency other than sterling, the amount of the issue shall be converted into sterling at the exchange rate prevailing in London on the date of issue.

statutory rules means the rules made by *FSA* under the Act.

subsidiary means, as defined in section 736 of the Companies Act 1985, (in relation to another body corporate (“H”)), a body corporate of which H is a *holding company*.

<i>Takeover Code</i>	means the City Code on Takeovers and Mergers issued by the Takeover Panel.
<i>takeover or related operation</i>	means: <ul style="list-style-type: none"> (a) any transaction falling within paragraph 3(b) (Companies, Transactions and Persons subject to the Code) of the introduction to the <i>Takeover Code</i> and, for this purpose, an offer for non-voting, non-equity share capital is to be regarded as falling within <i>Takeover Code</i> even if not required by rule 15 of that Code; (b) any transaction which would have fallen within (a) were it not for the fact that the company which is the subject of the transaction does not satisfy the tests set out in paragraph 3(a) (Companies, Transactions and Persons subject to the Code) of the introduction to the <i>Takeover Code</i>; (c) any offer, transaction or arrangement relating to the purchase of securities with a view to establishing or increasing a strategic holding of a person, or of a person together with his associates in the securities concerned; (d) any transaction or arrangement entered into in contemplation or furtherance of any offer, transaction or arrangement falling within (a) to (c); and (e) any transaction or arrangement entered into by way of defence or protection against any offer, transaction or arrangement falling within (a) to (d) which has taken place or which is contemplated.
<i>total capital requirement</i>	has the meaning given in rule 5.2.3(5) (Total capital requirement).
<i>trading book</i>	in relation to a <i>firm</i> 's business or <i>exposures</i> , means: <ul style="list-style-type: none"> (a) its proprietary positions in financial instruments: <ul style="list-style-type: none"> (i) which are held for resale and/or are taken on by the <i>firm</i> with the intention of benefiting in the short term from actual and/or expected differences between their buying and selling prices or from other price or interest-rate variations; (ii) arising from matched principal broking; (iii) taken in order to hedge other elements of the <i>trading book</i>; (b) <i>exposures</i> due to unsettled securities transactions, free deliveries, <i>OTC derivative</i> instruments, repurchase agreements and securities lending transactions based on securities included in (a)(i) to (iii) above, reverse repurchase agreements and securities borrowing transactions based on securities included in (a)(i) to (iii) above; and (c) fees, commission, interest and dividends, and margin on exchange-traded derivatives which are directly related to the items included in (a) and (b) above.
<i>trust beneficiary</i>	means a beneficiary under a trust (not being the settlor) who benefits from the performance by a <i>firm</i> as <i>trustee of investment services</i> relating to the management of the trust assets (in accordance with section 2372 of the <i>Act</i> (Other definitions)).
<i>trustee</i>	(in accordance with section 237(2) of the <i>Act</i> (Other definitions) (in relation to a unit trust scheme) the person holding the property in question on trust for the participants.
<i>trustee activity</i>	means, in relation to a <i>firm</i> , any activity undertaken in the course of or incidental to the exercise of any of its powers, or the performance of any of its duties, when acting in its capacity as a trustee.
<i>trustee firm</i>	means a <i>firm</i> which is not an <i>OPS firm</i> and which is acting as: <ul style="list-style-type: none"> (a) a <i>trustee</i>; or (b) a personal representative.
<i>UCITS qualifier</i>	see the meaning given to the term in the <i>Glossary</i>

<i>UK authorised investment firm</i>	means an <i>investment firm</i> . Note: A <i>UK authorised investment firm</i> is not necessarily a <i>firm</i> for the purposes of the <i>rules</i> .
<i>United Kingdom (UK)</i>	means England and Wales, Scotland and Northern Ireland, but not the Channel Islands or Isle of Man.
<i>unit trust manager</i>	means the manager of a <i>unit trust scheme</i> .
<i>unit trust scheme</i>	(as defined in section 237(1) of the <i>Act</i> (Other definitions)) means a <i>collective investment scheme</i> under which the property in question is held on trust for the participants.
<i>units</i>	means the rights or interests (however described) of the participants in a <i>collective investment scheme</i> .
<i>unregulated collective investment scheme</i>	means a <i>collective investment scheme</i> which is not a <i>regulated collective investment scheme</i> .
<i>venture capital investment</i>	means a <i>designated investment</i> which, at the time the investment is made, is: <ul style="list-style-type: none"> (a) in a new or developing company or venture; (b) in a management buy-out or buy-in; (c) made as a means of financing the investee company or venture and accompanied by a right of consultation, or rights to information, or board representation, or management rights; or (d) acquired with a view to, or in order to facilitate, a transaction falling within (a) to (c).
<i>warrant</i>	means the investment specified in article 79 of the <i>Regulated Activities Order</i> (Instruments giving entitlement to <i>investments</i>), which is, in summary: a <i>warrant</i> or other instrument entitling the holder to subscribe for a share, <i>debenture</i> or government and public security.
<i>zone a country</i>	see definition of <i>Zone A country</i> in the <i>Glossary</i>
<i>zone b country</i>	means a country which is not a <i>zone a country</i> .

6 Chapter 6: Service Companies

6.1 APPLICATION

6.1.1 R This chapter applies to *service companies*.

FINANCIAL RESOURCES REQUIREMENTS

6.1.2 R (1) A *service company* must be able to meet its liabilities as they fall due.

(2) In complying with (1) a *firm* may use any assets which are available to meet any of its liabilities.

7 UCITS MANAGEMENT COMPANIES

[Deleted: material moved to UPRU]

8 Requirements on credit unions which are CTF providers

8.1 Application, general and professional indemnity insurance requirements

Application

- 8.1.1R (1) This chapter applies to a *credit union* to the extent that it is a *CTF provider* whose *permissions* relate to *accepting deposits* and *making arrangements with a view to transactions in investments*.
- (2) The definitions in the Glossary at Appendix 13(1) apply to this chapter.

General requirements

8.1.2R A *credit union* to which this chapter applies must:

- (1) have and maintain at all times financial resources of the kinds and amounts specified in, and calculated in accordance with, the *rules* of this chapter, in *CRED* and, where applicable, in *MIPRU* 4 (Capital Resources); and
- (2) be able to meet its liabilities as they fall due.

8.1.3G The *rules* in this chapter should be read with the *rules* relating to capital in *CRED* and, where applicable, *MIPRU*.

Requirement to hold professional indemnity insurance

- 8.1.4G (1) Under *Principles* 3 and 4, a *credit union* is required to take reasonable care to organise and control its affairs responsibly and effectively with adequate risk management systems and to maintain adequate financial resources.
- (2) Although financial resources and appropriate systems and controls can generally mitigate operational risk, professional indemnity insurance has a role in mitigating the risks a *credit union* faces in its day to day operations. The purpose of *IPRU(INV)* 8.1.6R to *IPRU(INV)* 8.1.14E is to ensure that a *credit union* has in place the type, and level, of professional indemnity insurance necessary to mitigate these risks.

8.1.5R The term "relevant income" in *IPRU(INV)* 8.1 refers to all income received or receivable which is commission, brokerage, fees or other related income, whether arising from the *credit union's* activities related to *making arrangements with a view to transactions in investments* or not, for the last accounting year prior to inception or renewal of the professional indemnity insurance policy ("the policy").

8.1.6R A *credit union* must take out and maintain at all times professional indemnity insurance that is at least equal to the requirements of *IPRU(INV)* 8.1.7R to *IPRU(INV)* 8.1.14E.

Professional indemnity insurance policy terms

8.1.7R The professional indemnity insurance policy must incorporate terms which are appropriate and must make provision for:

- (1) cover in respect of any claim for loss or damage, for which the *credit union* may be liable as a result of an act or omission by:
 - (a) the *credit union*; or
 - (b) any *person* acting on behalf of the *credit union* including *employees, appointed representatives* or its other agents;
- (2) the minimum *limits of indemnity* in each year if the *credit union* is an *IMD insurance intermediary* as set out in *MIPRU 3.2.7R*;
- (3) the following *limits of indemnity* if the *credit union* is an investment intermediary other than an *IMD insurance intermediary*:
 - (a) if the *credit union* has relevant income of up to £3,000,000, no lower than £500,000 for a single claim against the *credit union* and £500,000 in the aggregate; or
 - (b) if the *credit union* has relevant income of more than £3,000,000, no lower than £650,000 for a single claim against the *credit union* and £1,000,000 in the aggregate.
- (4) If (2) applies, and the policy is denominated in any currency other than euros, a *credit union* must take reasonable steps to ensure that the *limits of indemnity* are, when the policy is effected (i.e. agreed) and at renewal, at least equivalent to those required in *IPRU(INV) 8.1.7R*.

Readily realisable own funds

8.1.8G For the purposes of the following provisions relating to professional indemnity insurance, the *FSA* expects items included in *own funds* to be regarded as “readily realisable” only if they can be realised, at any given time, within 90 days.

Additional requirements

- 8.1.9E
- (1) In addition to the specific requirements in *IPRU(INV) 8.1.7R*, to incorporate appropriate terms, the policy should make provision for the following:
 - (a) for a *credit union* with relevant income of more than £6,000,000, the aggregate limit identified in the table below:

Relevant income is (£)	Minimum aggregate <i>limit of</i>
------------------------	-----------------------------------

more than	up to	<i>Indemnity</i> (£)
6,000,000	7,000,000	1,150,000
7,000,000	8,000,000	1,300,000
8,000,000	9,000,000	1,450,000
9,000,000	10,000,000	1,600,000
10,000,000	12,500,000	2,000,000
12,500,000	15,000,000	2,400,000
15,000,000	17,500,000	2,800,000
17,500,000	20,000,000	3,150,000
20,000,000	25,000,000	3,800,000
25,000,000	30,000,000	4,250,000
30,000,000	35,000,000	4,500,000
35,000,000	40,000,000	4,750,000
40,000,000	50,000,000	5,500,000
50,000,000	60,000,000	6,000,000
60,000,000	70,000,000	6,750,000
70,000,000	80,000,000	7,250,000
80,000,000	90,000,000	7,750,000
90,000,000	100,000,000	8,500,000
100,000,000	150,000,000	11,250,000
150,000,000	200,000,000	14,000,000
200,000,000	250,000,000	17,000,000
250,000,000	300,000,000	19,750,000
300,000,000	n/a	22,500,000

- (b) full retroactive cover in respect of the kinds of liabilities described in *IPRU(INV)* 8.1.7R for claims arising from work carried out by the *credit union*, or on its behalf, in the past; and
- (c) cover in respect of *Ombudsman* awards made against the *credit union*.
- (2) Compliance with (1)(a) may be relied on as tending to establish compliance with the requirement in *IPRU(INV)* 8.1.7R for the professional indemnity insurance terms to be appropriate.

- (3) Contravention of (1)(a) may be relied on as tending to establish contravention of the requirement in *IPRU(INV)* 8.1.7R for the professional indemnity insurance terms to be appropriate.

8.1.10G A *credit union* should consider whether the overall cover is adequate taking account of *IPRU(INV)* 8.1.13G(2) and whether the *credit union* should seek additional cover or legal expenses insurance. (Legal defence costs are costs of defence against claims that fall under the terms of the policy.)

8.1.11G The cover provided by the policy should be wide enough to include the liability of the *credit union*, its *appointed representatives*, *employees* and its agents for breaches of the *credit union's* duty of skill and care, fiduciary duty, duty to look after documents or assets, fraud, and breaches of obligations imposed by or under the *Act*.

Exclusions

8.1.12R The policy must not be subject to conditions or exclusions which unreasonably limit the cover provided for in *IPRU(INV)* 8.1.7R (whether by exclusion of cover, by policy excesses or otherwise).

8.1.13 G (1) The *FSA* considers it reasonable for a *credit union's* policy to exclude cover for:

- (a) specific business lines if that type of business has not been carried out by the *credit union* in the past and will not be carried out by the *credit union* during the life of the policy; or
- (b) specific claims that have been previously notified to the *credit union's insurer* and claimed for under another policy.

(2) The *FSA* does not consider it reasonable for a *credit union's* policy to treat legal defence costs cover as part of the *limits of indemnity* if this reduces the cover available for any individual substantive claim.

8.1.14E (1) The policy should not:

- (a) make provision for payment by the *credit union* of an excess on any claim of more than £5,000. (This does not apply to the extent that the *credit union* holds additional *own funds* in a readily realisable form, in accordance with *IPRU(INV)* 8.1.16E); or
- (b) exclude any type of business or activity that has been carried out by the *credit union* in the past or will be carried out by the *credit union* during the time for which the policy is in force. (This does not apply to the extent that the *credit union* holds, by way of additional *own funds* in a readily realisable form, an amount equivalent to a reasonable provision against its potential liabilities for that business or activity. *Guidance* on

this is given in *IPRU(INV)* 8.1.17G and *IPRU(INV)* 8.1.18G);
or

(c) exclude liability which is identified or crystallised as a result of regulatory action against the *credit union* (either individually or as a member of a class of *authorised person*).

(2) Contravention of (1)(a) may be relied on as tending to establish contravention of *IPRU(INV)* 8.1.12R.

Excess level

8.1.15E The reference to “excess” in *IPRU(INV)* 8.1.14E(1)(a) is to the highest excess level required to be paid under the policy unless that excess relates to a type of business that has not been carried out by the *credit union* in the past. In those circumstances, the reference is to the next highest excess level required by the policy.

Additional own funds

8.1.16E The amount of additional *own funds* in *IPRU(INV)* 8.1.14E (1)(a) should be calculated by referring to the *credit union*'s relevant income and excess obtained in the following table:

All amounts are shown in £000s		Excess obtained, up to and including											
more than	up to	5	10	15	20	25	30	40	50	75	100	150	200+
0	100	0	4	7	9	12	14	18	21	28	34	45	54
100	200	0	7	11	14	17	20	25	29	38	46	59	70
200	300	0	9	14	18	21	24	30	35	45	54	69	82
300	400	0	11	16	21	24	28	34	39	50	60	77	91
400	500	0	13	18	23	27	30	37	43	55	66	83	98
500	600	0	14	20	25	29	33	40	46	59	70	89	105
600	700	0	16	22	27	31	35	42	49	63	74	94	111
700	800	0	17	23	28	33	37	45	52	66	78	99	117
800	900	0	18	24	30	35	39	47	54	69	82	103	122
900	1,000	0	19	26	31	36	41	49	56	72	85	107	126
1,000	1,500	0	23	31	37	43	48	57	66	83	99	124	146
1,500	2,000	0	26	35	42	48	54	64	73	93	109	138	161
2,000	2,500	0	29	38	46	53	59	71	81	102	121	152	179
2,500	3,000	0	32	42	51	58	65	78	89	112	132	166	195
3,000	3,500	0	35	46	55	63	71	84	96	121	142	179	210
3,500	4,000	0	38	50	59	68	76	90	102	129	152	191	223
4,000	4,500	0	41	53	63	72	80	95	108	137	161	202	236
4,500	5,000	0	43	56	67	76	85	100	114	144	169	212	248
5,000	6,000	0	48	62	73	84	93	110	125	157	185	231	271

6,000	7,000	0	52	67	79	90	101	119	135	169	199	249	291
7,000	8,000	0	56	72	85	97	107	127	144	181	212	265	310
8,000	9,000	0	59	76	90	103	114	134	152	191	224	280	328
9,000	10,000	0	63	80	95	108	120	141	160	201	236	294	344
10,000	100,000	0	63y	80y	95y	108y	120y	141y	160y	201y	236y	294y	344y
100,000	n/a	0	630	800	950	1080	1200	1410	1600	2010	2360	2940	3440
For <i>firms</i> with relevant income more than £10m but up to £100m value y is calculated by relevant income/ £10m													

Exclusions

8.1.17G A *credit union* should take into account the following when assessing the amount of additional *own funds* to be held as provision as described in *IPRU(INV)* 8.1.14E(1)(b):

- (1) the type of business line or activity excluded and the types of claim which might arise from it;
- (2) the number of contracts written or volume of activity;
- (3) the number of complaints received by the *credit union* relating to the excluded business or activity;
- (4) generally accepted accounting principles applicable to provisions; and
- (5) any other relevant information.

8.1.18G If the *credit union* holds additional *own funds* in accordance with *IPRU(INV)* 8.1.17G then the amount should be reviewed regularly. The reviews should take account of changes in the status of the policy exclusion(s) and any relevant changes to the *credit union*'s circumstances.

Policies providing cover for more than one credit union

8.1.19R If the policy provides cover to more than one *credit union* then in relation to *IPRU(INV)* 8.1.7R:

- (1) the relevant income for calculating the *limits of indemnity* is that of all the *credit unions* named in the policy combined;
- (2) each *credit union* named in the policy must have the benefit of the minimum *limits of indemnity* as required in *IPRU(INV)* 8.1.7R;
- (3) each *credit union* named in the policy must notify the *FSA* if the aggregate cover in the policy falls below the minimum in *IPRU(INV)* 8.1.7R.

Exemption from holding professional indemnity insurance

- 8.1.20R (1) A *credit union* is not required to effect or maintain professional indemnity insurance in relation to *insurance mediation activity*, if another *authorised person* which has net tangible assets of more than £10 million provides a comparable guarantee.
- (2) A ‘comparable guarantee’ means a written agreement on terms at least equal to those in *MIPRU* 3.2.4R to finance the claims that might arise as a result of a breach by the *credit union* of its duties under the *regulatory system* or civil law.
- 8.1.21R A *credit union* must take out professional indemnity insurance from:
- (1) any *insurance undertaking* which is authorised to transact professional indemnity insurance in the *EEA*; or
- (2) a *person* of equivalent status in:
- (a) a *Zone A country*;
- (b) the Channel Islands, Gibraltar, Bermuda or the Isle of Man.

Notification requirements

- 8.1.22G *Rule IPRU(INV)* 8.1.24R is a *notification rule* and is in addition to any notification requirements in the Supervision manual (*SUP* 15).
- 8.1.23G *Credit unions* are reminded to comply with *SUP* 15.7 (Form and method of notification) when notifying the *FSA* in accordance with *IPRU(INV)* 8.1.24R.
- 8.1.24R A *credit union* must notify the *FSA* immediately it becomes aware, or has information which reasonably suggests, that any of the matters in Table 8.1(1) has occurred, may have occurred or may occur in the foreseeable future.

Table 8.1(1)

This table forms part of *IPRU(INV)* 8.1.24R

NOTIFIABLE EVENTS
In relation to professional indemnity insurance, required in accordance with <i>IPRU(INV)</i> 8.1.6R to <i>IPRU(INV)</i> 8.1.21R, if:
(1) it cannot be obtained within 28 days of the inception or renewal date;
(2) it is cancelled;
(3) the amount of aggregate cover is exhausted;
(4) the <i>credit union</i> commences business lines for which it had not obtained cover;
(5) the <i>credit union</i> is relying on <i>IPRU(INV)</i> 8.1.19R; or

(6) the *credit union* is relying on *IPRU(INV)* 8.1.20R.

8.2 Capital requirements

8.2.1R 'Capital' in this chapter has the meaning described in *CRED* 8.2.1R.

8.2.2R A *version 1 credit union* with total assets of more than £5 million or a total number of members of more than 5,000, or both, or a *version 2 credit union*, which acts as a *CTF provider* and whose *permissions* include *regulated activities* relating to *accepting deposits* and *making arrangements with a view to transactions in investments* other than *contracts of insurance* or *rights to or interests in a life policy* must maintain at all times capital which is equal to the higher of:

- (1) £10,000; and
- (2) the capital requirements for the *credit union* under *CRED*.

8.2.3R A *version 1 credit union* with total assets of more than £5 million or a total number of members of more than 5,000, or both, or a *version 2 credit union*, which acts as a *CTF provider* which *makes arrangements with a view to transactions in investments* including *contracts of insurance* or *rights to or interests in a life policy* must maintain at all times capital which is equal to the highest of:

- (1) £10,000;
- (2) the capital requirements for the *credit union* under *CRED*; and
- (3) the capital requirements for the *credit union* under *MIPRU* 4.

10 Chapter 10: Financial resources for Securities and Futures Firms which are Investment Firms

10-A R The definitions in the glossary at Appendix 1 apply to this chapter.

APPLICATION

10-B R This chapter applies to a *securities and futures firm* which is an *investment firm* and to a *category D firm*.

G Consequently this chapter does not apply to *lead regulated firms* and *passported institutions* (without a top-up permission).

10-10 Keeping of records

Records to be up-to-date

10-10(1) R A *firm* must keep records in accordance with rules 10-10 to 10-12 on a continual basis so that at all times records are up-to-date or able to be brought up-to-date within a reasonable time.

Adequacy of records

10-10(2) R A *firm* must keep records in such a manner that they are sufficient to show and explain the *firm's* transactions and commitments (whether effected on its own behalf or on behalf of others) and in particular so that these records:

- (a) disclose with reasonable accuracy the financial position of the firm at any point in time within the previous six years when the firm was authorised by the *FSA* or a predecessor regulator;
- (b) demonstrate whether or not the *firm* is or was at that time complying with its *financial resources requirement*; and
- (c) enable the *firm* to prepare within a reasonable time any *financial reporting statement* as at the close of business of any date within the previous six years when the *firm* was authorised by the *FSA* or a predecessor regulator, and such that the statement complies with the requirements of the rules of the *FSA*.

Content of records

10-10(3) A firm must ensure that its records contain as a minimum:

Financial

- (a) entries from day to day of all sums of money received and expended by the *firm* whether on its behalf or on behalf of others, and the matters in respect of which the receipt and expenditure takes place;**
- (b) a record of all income and expenditure of the *firm* explaining its nature;**
- (c) a record of all assets and liabilities of the *firm* including any commitments or *contingent liabilities*;**
- (d) entries from day to day of all purchases and sales of *investments* by the *firm* distinguishing those which are made by the *firm* on its own account and those which are made by or on behalf of others;**
- (e) any working papers necessary to show the preparation of any *reporting statement* or any other periodic return to the *FSA*;**

Risk management

- (m) details of exposure limits for trading positions and counterparty credit limits which are appropriate to the type, nature and volume of business undertaken, in such a way that they are capable of being summarised to enable actual exposures to be measured readily and regularly against these limits;**
- (n) management information records maintained in a manner such that they disclose, or are capable of disclosing, in a prompt and appropriate fashion, the financial and business information which will enable the *firm's* management to:**
 - (i) identify, quantify, *control* and manage the *firm's* risk exposures;**
 - (ii) make timely and informed decisions;**
 - (iii) monitor the performance of all aspects of the *firm's* business on an up-to-date basis;**
 - (iv) monitor the quality of the *firm's* assets; and**

- (v) **safeguard the assets of the *firm*, including assets for which the *firm* is accountable belonging to other persons.**

G The FSA does not consider it possible to prepare an exhaustive and prescriptive list of record keeping requirements applicable to all *firms*. The detailed requirements will vary according to the manner in which the business is structured, organised and managed; its size; and the nature, volume and complexity of its transactions and commitments.

Reconciliation of firm's balances

10-11 Reconciliation

- 10-11(1) R **A *firm* must reconcile all balances with banks or building societies (other than a client bank account subject to the Client Money Rules) as recorded by the *firm* to the balance on the statement issued by the bank or building society and must correct any difference forthwith, unless it arises solely as a result of identified differences in timing between the records of the *firm* and the bank or building society.**
- 10-11(2) R **A *firm* must reconcile all balances and positions with *exchanges*, *clearing houses* and *intermediate brokers* as recorded by the *firm* to the balance or position on a statement or circularisation obtained by the *firm* from the *exchange* etc and must correct any differences by agreement with the *exchange* etc on a timely basis.**
- 10-11(3) R **A *firm* must perform *reconciliations* under (1) and (2) above as frequently as is appropriate for the volume of transactions on the accounts and in any event not less than once every five weeks.**
- 10-11(4) R **A *firm* must reconcile all balances and *securities* positions with each counterparty which is a member of an *exchange* as recorded by the *firm* to the balance or position on a statement or circularisation obtained by the *firm* from the counterparty except to the extent that the balances and *securities* positions due to and from the counterparty have been agreed by other means, and must correct any differences by agreement with the counterparty on a timely basis*.**
- 10-11(5) R **A *firm* must perform *reconciliations* under (4) above as frequently as is appropriate for the volume of transactions on the accounts and in any event not less than once every year.**

* For guidance notes on the *reconciliation* of a *firm's* balances with a *counterparty* which is a member of an *exchange*, see Appendix 20

Response to requests

- 10-11(6) R **A firm must use its best endeavours to respond within one month of receipt to any circularisation from another firm requesting confirmation of outstanding balances.**

10-12 Nature, accessibility and retention of records

Nature of records

- 10-12(1) R **A firm may keep a record in any form provided that the record can be reproduced promptly in hard printed form in English.**
- 10-12(2) R **Where all the records relating to a counterparty are not kept together, a firm must ensure that each location where documents relating to that counterparty are retained contains an indication that other records relating to that counterparty exist and how access to them can be obtained.**
- 10-12(3) R **A firm may accept and rely on records supplied by a third party so long as those records are capable of being and are reconciled with records held by the firm.**

Audit trail

- 10-12(4) R **A firm must record the information required by rules 10-10 to 10-13 in such a way as to enable a particular transaction to be identified at any time and traced through the accounting systems of the firm, in particular in such a manner as to enable early identification of aggregated transactions and of the particular items which have contributed to those aggregated transactions.**
- 10-12(5) R Retention of records
- (a) **A firm must ensure that all records relating to the current year are arranged, filed and indexed so as to permit prompt access to any particular record.**
- (b) **During the most recent year, a firm must keep these records either at a place where the firm carries on business or in such a manner that they can be produced at such a place within 24 hours of their being requested and thereafter, within 48 hours.**
- (c) **A firm must keep all records required by rules 10-10 to 10-12 for a period of six years after the date on which they are first made or prepared.**

Security of records

- 10-12(6) R** **A firm must have adequate procedures for the maintenance, security, privacy and preservation of records, working papers and other documents of title belonging to the firm or others so that they are reasonably safeguarded against loss, unauthorised access, alteration or destruction.**

Notification requirements for category A, B and C firms

Application

- 10-32(1) R** **This rule applies only to category A, B and C firms.**

Counterparty default on a repurchase transaction etc.

- 10-32(2) R** **A firm must notify the FSA as soon as it has reason to believe that a counterparty with which it has entered into a repurchase, reverse repurchase, securities or physical commodities lending, securities or physical commodities borrowing, sale and buy back or buy and sale back agreement has defaulted on its obligations.**

Large exposures

- 10-32(3) R** **Subject to (7) below, a firm must notify the FSA of the following:**
- (a) at the end of each quarter, all large exposures which have occurred during the preceding quarter, stating the amount of the highest large exposure and the name of the third parties concerned;**
 - (b) as soon as it has reason to believe that it is or will be in breach of the limits specified in rule 10-193, stating the amount and cause of the exposure and the name of the third parties concerned, together with details of the steps which it is taking, or has taken to remedy or prevent the breach.**
- 10-32(5) R** **Subject to (7) below, a firm must notify the FSA:**
- (a) at the end of each quarter, all group large exposures which have occurred during the preceding quarter, stating the amount of the highest large exposure and the third parties involved;**

- (b) as soon as it has reason to believe that it is or will be in breach of the limits specified in rule 10-193, stating the amount and cause of the *exposure* and the name of the third parties involved, together with details of the steps which it is taking, or has taken to remedy or prevent the breach.

10-32(6) R A *firm* which is subject to the waiver from consolidated supervision in accordance with rule 14.1.4R is exempt from (5) above.

10-32(7) R A *firm* is not required to notify the *FSA* of the following:

- (a) *large exposures* to or guaranteed by *Zone A* central governments and central banks and by the *European Communities*; and
- (b) *large exposures* secured by *securities* issued by *Zone A* central governments and central banks and by the *European Communities*.

Repurchase and reverse repurchase, securities or physical commodities lending and borrowing and sale and buy back agreements

10-41(7) R Where a *firm* has entered into a *repurchase, reverse repurchase, securities or physical commodities* lending, *securities or physical commodities* borrowing, *sale and buy back, or buy and sale back agreement* (whether or not *undocumented*), it must:

- (c) *mark to market* the cash borrowed or lent; except that if the residual maturity of the transaction is less than one month, a *firm* may instead provide for accrued interest on the amount borrowed or lent;

10-41 (7A) R (a) Cash borrowed or lent under a *repurchase or reverse repurchase agreement*, or under any similar agreement in which cash is lent or borrowed against security and at a fixed interest rate, as well as *trading book* deposits and cash borrowings, must be included in the interest rate method as outlined in Rule 10-101(14) and (15).

- (b) If less than one month remains until maturity, a *firm* may choose to omit such transactions from its *PRR* calculations.

Valuation of positions*

- 10-41(9) R** A *firm* must value both *trading book* positions and *non-trading book investment* positions on a prudent and consistent basis, as well as having regard to the liquidity of the instrument concerned and any special factors which may adversely affect the closure of the position, and must adopt the following general policies:
- (a) a position must be valued at its close out price (close out price means that a long position shall be valued at current bid price and a short position at current offer price); where firm two way prices are not available a *firm* must value its position in accordance with the notes to this rule; *
 - (b) where a firm has been granted a modification or *waiver* by the FSA to use a CAD1 or VaR model in the calculation of its PRR (as described in the guidance at Appendix 10 and 11), it may value its positions in instruments within the scope of that *waiver* using the values derived from the internal valuation model(s) that the firm uses to produce feeds fro that CAD1 or VaR model;
 - (c) where prices are not published for its *options* positions and a *firm* does not have a *waiver* to use a model to value them, it must determine the *mark to market* value of standard European and American *options* as follows:
 - (i) for purchased *options*, the *mark to market* value must be the *in the money* amount multiplied by the quantity underlying the *option*;
 - (ii) for written *options*, the *mark to market* value must be the sum of:
 - (aa) the *in the money* amount multiplied by the quantity underlying the *option*; and
 - (bb) the initial premium received for the *option*;
- G If a written *option* was *in the money* at the time the contract was written, *in the money* amount in (aa) may be taken to be the current *in the money* amount less the *in the money* amount at the time the contract was written.

* For notes on the valuation of positions, see **Appendix 21**

- (d) a *firm* must calculate the value of a *swap* contract or an *FRA* having regard to the net present value of the *future* cash flows of the contract, using current interest rates relevant to the periods in which the cash flows will arise.
- (e) in the case of interest rate *swaps*, currency *swaps* and *FRAs*, a *firm* may limit the bid/offer valuation required under (a) above to its net position.

G The *FSA* does not consider it appropriate to lay down a precise formula for calculating the value of *swaps* and *FRAs*. However, it will expect a *firm* to employ a valuation formula which accords with generally accepted market practice.

Instruments of non-standard form

10- 41(10) G If a *firm* holds a position in an instrument that is not of a standard form, it should seek guidance from the *FSA* about the valuation treatment which it will apply to that instrument.

Valuing instruments at a maximum loss

10-41(11) R A *firm* may exclude a position from its *PRR*, *CRR* and *LER* calculations if it values the position in either of the two following ways and it notifies the *FSA* in writing that it is doing so:

- (a) a short position that is valued at maximum loss; or
- (b) a long position that is valued at zero.

G For example, a *firm* might write a one touch digital *option* which requires the *firm* to pay out £100 where the price of the underlying exceeds a certain threshold. In the worst case (including ignoring the time value of money) the *firm* would lose £100 overall. If the *firm* valued this position at -£100 it would not have to include this position in its *PRR*, *CRR*, and *LER* calculations.

Initial Capital and Financial Resources

10-60

FIRMS TO WHICH RULES 10-61 TO 10-196 APPLY

Category A, B and C firms

10-60(1) R Rules 10-61 to 10-196 apply to a *category A, B or C firm*.

Category D firms

10-60(2) R Rules 10-61 to 10-176 apply to a *category D firm*, except that a *corporate finance advisory firm* which is a *category D firm* must instead comply with rules 3-60(3), 3-62, 10-61 and 10-63.

10-60(3) R A *category D firm* whose *permission* includes *establishing, operating or winding up a personal pension scheme* must comply with the higher of the financial resources requirements applied by rules 10-60 to 10-176 and the requirements applied by rules 5.2.1(1) to 5.2.7(5) of IPRU(INV).

10-61

INITIAL CAPITAL

General rule

10-61(1) R A *firm* must:

- (a) on authorisation, hold *initial capital*, calculated in accordance with Table 10-61(1)A below, in excess of its *initial capital* requirement as detailed in (8) below; and
- (b) at all times, maintain *own funds*, calculated in accordance with Table 10-61(1)B below, in excess of its *initial capital* requirement as detailed in (8) below.

R TABLE 10-61(1)A - Initial capital

the sum of - ordinary share capital non cumulative preference share capital share premium account reserves excluding revaluation reserves audited retained earnings externally verified interim net profits or current account partners' capital account <i>eligible LLP members' capital</i>

<i>initial capital</i>

R TABLE 10-61(1)B - Own funds

the sum of - ordinary share capital non cumulative preference share capital share premium account reserves excluding revaluation reserves audited retained earnings externally verified interim net profits or current account partners' capital account <i>eligible LLP members' capital</i>	
<i>initial capital</i>	(A)
the sum of - investments in own shares intangible assets material interim year net losses <i>excess LLP members' drawings</i>	(B)
A - B = <i>original own funds</i>	(C)
the sum of - non fixed term cumulative preference shares fixed term cumulative preference shares non fixed term long term subordinated loans fixed term long term subordinated loans revaluation reserves	(D)
the sum of - <i>material holdings in credit and financial institutions material insurance holdings</i>	(E)
C + D - E = <i>own funds</i>	(F)

Preference share capital

10-61(2) R A firm may include preference share capital in *financial resources* only if:

- (a) there is an agreement between the *firm* and the holders of those shares which provides that redemption of the shares may not take place, if after such redemption the *firm* would be in breach of rule 10-62(1); and**
- (b) the *firm* notifies the *FSA* in writing before issuing any preference shares of its intention to do so.**

Non cumulative preference share capital

- 10-61(3) R** **A firm may include preference *share capital* in *initial capital* only where the dividends are not cumulative.**

Audited retained earnings

- 10-61(3A) R** **When calculating *initial capital*, a firm may include its audited retained earnings only after making the following adjustments:**

- (a) 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;**
- (b) in respect of a *defined benefit occupational pension scheme*, a firm must derecognise any *defined benefit asset*;**
- (c) a firm must not include any unrealised gains from investment property (these should be reported as part of revaluation reserves);**
- (d) 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 exclude 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

- 10-61(4) R** **A firm may include interim net profits or current account when calculating *initial capital* to the extent that they have been:**

- (a) verified by the firm's external auditor; and**
- (b) a copy of his opinion thereon, drawn up in accordance with the relevant requirements of Appendix 58, has been submitted to the FSA,**

and are net of any foreseeable charge, dividend or proprietor's drawings.

- 10-61(4A) R** **When calculating *initial capital*, a firm may include its partners' current accounts figure only after making the following adjustments:**

- (a) 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;**
- (b) in respect of a *defined benefit occupational pension scheme*, a**

firm must derecognise any defined benefit asset;

- (c) **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 exclude 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

- 10-61(4B) R **For the calculation of *original own funds*, 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.**

- 10-61(4C) G **A *firm* should keep a record of and be ready to explain to its supervisory contacts in the *FSA* 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*.**

Intangible assets

- 10-61(5) R **A *firm* must deduct from *initial capital*, when calculating *original own funds*, the full balance sheet value of intangible assets including goodwill, capitalised development costs, licences, exchange seats held as part of its trading requirement, trademark and similar rights etc. Intangible assets do not include a deferred acquisition cost asset.**

Material interim losses

- 10-61(6) R **A *firm* must deduct from *initial capital* when calculating *original own funds* all material unaudited interim losses arising from its *trading book* and *non-trading book* business which exceed 10% of its *initial capital*.**

Material holdings in credit and financial institutions

- 10-61(7) R **A *firm* must deduct the full value of its *material holdings* in *credit* or *financial institutions*, in accordance with Table 10-61(1)B, unless:**
- (a) **the *firm* has been granted a waiver from *IPRU (INV)* 14rules 10-200 to 10-203, in which case it must:**
- (i) **deduct in full from *original own funds* those *material holdings* in *credit* or *financial institutions* which would have been included in the scope of consolidation in accordance with rule 10-200(3) if the waiver had not been granted; and**

- (ii) deduct in full as an *illiquid asset* any *material holding* in a *credit* or *financial institution* which would not have been included in the scope of consolidation, unless it is included in the *firm's trading book*, in which case the *firm* may treat it under the *PRR* rules; or
- (b) the *firm* has notified the *FSA* in writing that it intends to calculate its *financial resources* in accordance with Table 10-62(2)C, in which case it must deduct in full as an *illiquid asset* any *material holding* in a *credit* or *financial institution*, unless it is included in the *firm's trading book*, in which case the *firm* may treat it under the *PRR* rules; or
- (c) the *material holding* is a *trading book* position, in which case the *firm* must deduct in accordance with Table 10-61(1)B the full value of that proportion of the holding which exceeds 10% of the *firm's own funds*, and that segment of the *material holding* which falls below the 10% of *own funds* threshold may instead be treated in accordance with the *PRR* rules.

Initial capital requirement

- 10-61(8) R A *firm's initial capital* requirement must be:
- (a) for a *category A firm* : euro 730,000;
 - (b) for a *category B firm* : euro 125,000;
 - (c) for a *category C firm* : euro 50,000; or
 - (d) for a *category D firm* : euro 50,000.

10-62 FINANCIAL RESOURCES

General rule

- 10-62(1) R A *firm* must, at all times, maintain *financial resources* in excess of its *financial resources requirement* as detailed in rule 10-70 below.

Calculation of financial resources

- 10-62(2) R A *firm* must calculate its *financial resources* in accordance with Table 10-62(2)A below, unless:
- (a) it has been granted a waiver from *IPRU (INV) 14* rules 10-200 to 10-203, in which case it must calculate *financial resources* in accordance with Table 10-62(2)B; or

(b) the firm has notified the FSA in writing that it intends to calculate its financial resources in accordance with Table 10-62(2)C.

- G The FSA expects a firm to calculate financial resources on a consistent basis and only change the version which it follows in exceptional circumstances. A firm that wishes to change the basis of calculation should inform the FSA in writing of its reasons for changing the basis for its calculation of financial resources.

R TABLE 10-62(2)A - Financial resources - version I

the sum of - ordinary share capital non cumulative preference share capital share premium account reserves excluding revaluation reserves audited retained earnings externally verified interim net profits or current account partners' capital account <i>eligible LLP members' capital</i>	
<i>initial capital</i>	(A)
the sum of - <i>investments</i> in own shares intangible assets material interim net losses <i>excess LLP members' drawings</i>	(B)
A - B = <i>original own funds</i>	(C)
the sum of - non fixed term cumulative preference shares fixed term cumulative preference shares non fixed term long term subordinated loans fixed term long term subordinated loans revaluation reserve	(D)
the sum of - liquidity adjustments charged assets <i>contingent liabilities</i> deficiencies in <i>subsidiaries</i>	(E)
the sum of - short term subordinated loan net interim <i>trading book</i> profit & loss partners' interim <i>trading book</i> current account	(F)
the sum of - <i>material holdings</i> in credit and financial institutions <i>material insurance holdings</i>	(G)
C + D - E + F - G = <i>financial resources</i>	

R TABLE 10-62(2)B - Financial resources - version II

the sum of - ordinary share capital non cumulative preference share capital share premium account reserves excluding revaluation reserves audited retained earnings externally verified interim net profits or current account partners' capital account eligible LLP members' capital	
<i>initial capital</i>	(A)
the sum of - <i>investments</i> in own shares intangible assets material interim net losses excess LLP members' drawings	(B)
A - B = <i>original own funds</i>	(C)
<i>material holdings</i> in <i>credit</i> and <i>financial institutions</i> included in the scope of consolidation	(D)
the sum of - non fixed term cumulative preference shares fixed term cumulative preference shares non fixed term long term subordinated loans fixed term long term subordinated loans revaluation reserve	(E)
the sum of - liquidity adjustment on other <i>non-trading book</i> assets charged assets <i>contingent liabilities</i> deficiencies in <i>subsidiaries</i>	(F)
the sum of - short term subordinated loan net interim <i>trading book</i> profit & loss partners' interim <i>trading book</i> current account	(G)
<i>the sum of</i> - <i>material holdings</i> in <i>credit</i> and <i>financial institutions</i> <i>material</i> <i>insurance holdings</i>	(H)
liquidity adjustment on <i>illiquid assets</i>	(I)
C - D + E - F + G - H - I = <i>financial resources</i>	

R TABLE 10-62(2)C - Financial resources - version II.2

the sum of - ordinary share capital non cumulative preference share capital share premium account reserves excluding revaluation reserves audited retained earnings externally verified interim net profits or current account partners' capital account <i>eligible LLP members' capital</i>	
<i>initial capital</i>	(A)
the sum of - <i>investments</i> in own shares intangible assets material interim net losses <i>excess LLP members' drawings</i>	(B)
A - B = <i>original own funds</i>	(C)
the sum of - non fixed term cumulative preference shares fixed term cumulative preference shares non fixed term long term subordinated loans fixed term long term subordinated loans revaluation reserve	(D)
the sum of - liquidity adjustment on other <i>non-trading book</i> assets charged assets <i>contingent liabilities</i> deficiencies in <i>subsidiaries</i>	(E)
the sum of - short term subordinated loan net interim <i>trading book</i> profit & loss partners' interim <i>trading book</i> current account	(F)
<i>the sum of -</i> <i>non-trading book material holdings</i> in <i>credit and financial institutions</i> <i>material insurance holdings</i>	(G)
liquidity adjustment on <i>illiquid assets</i>	(H)
C + D - E + F - G - H = <i>financial resources</i>	

10-63 SUBORDINATED LOAN

Calculation

10-63(1) R A firm may take into account subordinated loan capital in its *financial resources* in accordance with Tables 10-62(2)A, B and C subject to (2) to (12) below.

Approved of subordinated loans

10-63(2) R A firm may include a subordinated loan in its *financial resources* only:

- (a) if it is drawn up in accordance with the standard forms obtained from the FSA;**
- (b) if it is signed by authorised signatories of all the parties; and**
- (c) to the extent that it is paid up by the lender.**

G If a *firm* wishes to use a form which differs from the standard form it will need to seek a modification to, or waiver from, this rule.

G A *firm* may, under the provisions of IPRU(INV) 1.2.5R continue to include a subordinated loan in its *financial resources* if it was entitled to do so immediately prior to the *specified day*, and the other conditions set out in IPRU(INV) 1.2.5R are met.

Approved lenders

10-63(3) R A firm may treat a subordinated loan as part of *financial resources* only if the lender is:

- (a) the *firm's controller*;**
- (b) a *credit institution*;**
- (c) an *approved person*; or**
- (d) an *EEA or recognised third country investment firm*.**

G If the *firm* wishes to treat as part of its *financial resources* a subordinated loan from a person not within the above categories, it will need to seek a modification or waiver from the FSA.

Type of subordinated loan

10-63(4) R A firm's subordinated loans must be classified as one or other of the following:

- (a) long term subordinated loan; or**
- (b) short term subordinated loan.**

Long term subordinated loan

- 10-63(5) R A firm's long term subordinated loan must have an original maturity of at least five years.**

Repayment of long term subordinated loan

- 10-63(6) R A firm must not (except in accordance with the terms of the loan):**
- (a) repay, prepay or terminate a long term subordinated loan before the agreed repayment date unless it has provided the FSA with at least five years' written notice; and**
 - (b) make any payment of interest if after such action the firm's financial resources will fall below 120% of its financial resources requirement.**

Amounts repayable within five years

- 10-63(7) R A firm must reduce the extent to which the long term subordinated loan may contribute to its financial resources on a straight line basis over the last five years of its life.**

Short term subordinated loan

- 10-63(8) R A firm's short term subordinated loan must have an original maturity of at least two years.**

Repayment of short term subordinated loan

- 10-63(9) R A firm must not (except in accordance with the terms of the loan):**
- (a) repay, prepay or terminate a short term subordinated loan before the agreed repayment date; and**
 - (b) make any payment of interest or principal if after such action the firm's financial resources will fall below 120% of its financial resources requirement.**

- 10-63 (9A) R If a firm has a surplus of long term subordinated loan, which it may not include in its financial resources, because it would breach the gearing limits in rule 10-63(10) and (11), it may substitute such surplus long term subordinated loan in place of short term subordinated loan in accordance with Tables 10-62(2)A and B, provided that it continues to comply with the gearing limits in rules 10-63(12).**

Limits on subordinated loans, cumulative preference shares and revaluation reserves

- 10-63 (10)** R The total amount of long term subordinated loan, cumulative preference shares and revaluation reserves which a *firm* may take into account in its *financial resources* must not exceed 100% of *original own funds* as specified in Table 10-62(2)A, B or C as appropriate.
- 10-63 (11)** R The total amount of fixed term long term subordinated loan and fixed term cumulative preference shares which a *firm* may take into account in its *financial resources* must not exceed 50% of *original own funds* in Table 10-62(2)A, B or C as appropriate.
- 10-63 (12)** R The total amount of short term subordinated loan (including any surplus long term subordinated loan) which a *firm* may take into account in its *financial resources* must not exceed:
- (a) for a *firm* which calculates its *financial resources* in accordance with Table 10-62(2)A, 200% of the *original own funds* left after the items calculated as line “E” in Table 10-62(2)A have been deducted;
 - (b) for a *firm* which calculates its *financial resources* in accordance with Table 10-62(2)B, 250% of *original own funds* left after the items calculated as lines “D” and “F” in Table 10-62(2)B have been deducted; or
 - (c) for a *firm* which calculates its *financial resources* in accordance with Table 10-62(2)C, 250% of *original own funds* left after the items calculated as line “E” in Table 10-62(2)C have been deducted.
- G In respect of (a) above, a *firm* may use the items of capital listed in “D” in Table 10-62(2)A to cover the items in line “E” before it uses *original own funds* to cover the items in line “E”.
- G In respect of (b) above, a *firm* which has been granted a waiver from *IPRU (INV) 14* may use the items of capital listed in “E” in Table 10-62(2)B to cover the items in line “F” before it uses *original own funds* to cover the items in line “F”.
- G In respect of (c) above, any other *firm* which the *FSA* has agreed may calculate its *financial resources* in accordance with Table 10-62(2)C may use the items of capital listed in “D” in Table 10-62(2)C to cover the items in “E” before it uses *original own funds* to cover the items in line “E”.

10-64 LIQUIDITY ADJUSTMENT

General rule

- 10-64(1) R** A *firm's* liquidity adjustment for its assets must be calculated -
- (a) for *illiquid assets*, other than *commodities*, in accordance with rule 10-65; and
 - (b) for other *non-trading book* assets, other than *commodities*, in accordance with rule 10-66;
 - (c) for all *commodities* in accordance with appendix 6 (commodities PRR) and rule 10-170 (CRR).

Intangible assets

- 10-64(2) R** The liquidity adjustment for intangible assets is nil (these must be deducted from *initial capital* to arrive at *original own funds* in accordance with rule 10-61(5)).

Debtors arising from trading book business

- 10-64(3) R** Debtors arising from *trading book* business have no liquidity adjustment but instead are subject to the *CRR* rules.

Netting

- 10-64(4) R** A *firm* which has offsetting exposures in similar types of transactions with a counterparty may offset these in accordance with rules 10-65(13) and 10-66(6) when calculating its liquidity adjustment if it has a contractual netting agreement with that counterparty, which:
- (a) covers the transactions which the *firm* is seeking to net;
 - (b) creates a single obligation in each currency or a single overall obligation to pay (or receive) a net sum of cash in the event of default, bankruptcy, liquidation or similar circumstances;
 - (c) does not include a *walkaway clause*; and
 - (d) is supported by written and reasoned independent legal opinions to the effect that, in the event of a legal challenge, the relevant courts would find the *firm's* exposure to be the single net amount mentioned in (b) above.

G Legal opinions should relate to:

- (a) the law of the jurisdictions in which the counterparty is organised;

- (b) the law of the jurisdiction in which any branch involved is located;
 - (c) the law that governs the agreement and, if different, the law that governs individual transactions pursuant to it; and
 - (d) the law that governs the legal status of the counterparty who is entering into transactions of the type which the *firm* is seeking to net.
- G Where a *firm* uses a standard netting agreement and the netting/set-off clauses therein follow the form of that standard agreement, provided a legal opinion has already been obtained on the standard agreement which addresses the capacity of counterparties of the type with which the *firm* wishes to contract, that may be relied upon.
- G Legal opinions on netting agreements should be obtained from independent legal advisers with sufficient expertise and experience in this area of law. Opinions from in-house counsel will not be acceptable.
- G Where the regulator of the counterparty is not satisfied that the netting agreement is enforceable under its laws, the netting agreement cannot be relied upon regardless of the opinions obtained by the *firm*.
- G A *firm* may not net balance sheet payables and receivables arising from derivative transactions in the *non-trading book* against other exposures arising in the *non-trading book*.
- G A *firm* wishing to net counterparty balances in the *non-trading book* against counterparty balances in the *trading book* should apply to the FSA for relevant modification or waivers.

10-65 LIQUIDITY ADJUSTMENT ON ILLIQUID ASSETS

General rule

- 10-65(1) R A *firm's* total liquidity adjustment on its *illiquid assets* is the sum of the amounts calculated in accordance with (2) to (12) below, applying either:**
- (a) 8% multiplied by the appropriate counterparty weight* (where applicable), for *firms* who calculate their *financial resources* in accordance with Table 10-62(2)A; or**
 - (b) 100%, for *firms* who calculate their *financial resources* in accordance with Table 10-62(2)B or C.**

* for details of counterparty weights see **Appendix 47**

Tangible fixed assets

- 10-65(2) R** The liquidity adjustment for tangible fixed assets is either 8% or 100% of the total net book value of such assets, except that where a *firm* calculates its *financial resources* in accordance with Table 10-62(2)B or C it may calculate the liquidity adjustment for land and buildings used as security for *non recourse loans* or other loans in accordance with (3) and (4) below.

Land and buildings used as security for non recourse loans

- 10-65(3) R** The liquidity adjustment for land and buildings used as security for a *non recourse loan* is the difference between the net book value of the land or building and the loan principal outstanding, except where the loan principal outstanding is higher than the net book value in which case there is no liquidity adjustment.

Land and buildings used as security for other loans

- 10-65(4) R** The liquidity adjustment for land and buildings used as security for loans other than *non recourse loans* is the difference between the net book value of the land or building and the lower of:
- (a) 85% of a professional valuation of the land and buildings (which must have been carried out in the last two years); and
 - (b) the principal outstanding,

except where both (a) and (b) are higher than the net book value in which case there is no liquidity adjustment.

Physical stocks

- 10-65(5) R** The liquidity adjustment for physical stocks is either 8% or 100% of the balance sheet value of such stocks, except for stock positions in physical commodities associated with the *firm's investment business*, which are subject to the *PRR* rules, in which case there is no liquidity adjustment.

Investments in credit institutions and financial institutions

- 10-65(6) R** The liquidity adjustment for an *investment* in either a *credit institution* or *financial institution*, which may be included in the *own funds* of that institution is either 8% multiplied by the appropriate counterparty weight* applicable to the issuer of the *investment* or 100% of the balance sheet value of the *investment*, except where the *investment* is:
- (a) a *material holding* in a *credit institution* or *financial institution*, in which case it must be treated in accordance with (12) below; or
 - (b) not a *material holding* and is included in the *firm's trading book*, in which case there is no liquidity adjustment but such an *investment* must be subject to the *PRR* rules.

Other investments

- 10-65(7) R** The liquidity adjustment for other *investments* is either 8% multiplied by the appropriate counterparty weight* applicable to the issuer of the *investment* or 100% of the balance sheet value of the *investment*, except where:
- (a) the *investment* is included in the *firm's trading book*, in which case there is no liquidity adjustment but such an *investment* must be subject to the *PRR* rules; or
 - (b) the *investment* is suspended, in which case the *firm* must calculate a liquidity adjustment of 100% of the value of the *investment*.

Other debtors

- 10-65(8) R** The liquidity adjustment for debtors other than debtors arising from *trading book* business, where the debt is not due to be repaid within 90 days, is either 8% multiplied by the appropriate counterparty weight*, or 100% of the balance sheet value of the debtor, except that there is no liquidity adjustment for amounts due which are secured by *acceptable collateral*.

* for details of counterparty weights see **Appendix 47**

Other cash deposits

- 10-65(9) R** The liquidity adjustment for a cash deposit other than a *qualifying deposit* is either 8% multiplied by the appropriate counterparty weight*, or 100% of the balance sheet value of the deposit, except that there is no liquidity adjustment for amounts due which are secured by *acceptable collateral*.

Loans

- 10-65 (10) R** The liquidity adjustment for a loan granted by a *firm* which is not due to be repaid within 90 days is either 8% multiplied by the appropriate counterparty weight*, or 100% of the balance sheet value, except that there is no liquidity adjustment for amounts due which are secured by *acceptable collateral*.

Other assets

- 10-65 (11) R** The liquidity adjustment for assets other than those specifically stated above where the asset is not due to be repaid within 90 days, is either 8% multiplied by the appropriate counterparty weight*, or 100% of the balance sheet value, except that there is no liquidity adjustment for amounts due which are secured by *acceptable collateral*. Other assets do not include a *defined benefit asset* or a deferred acquisition cost asset.

Material holdings in credit and financial institutions

- 10-65 (12) R** The liquidity adjustment for a *material holding* in either a *credit* or *financial institution* is:
- (a) for a *firm* which calculates its *financial resources* in accordance with Table 10-62(2)A: zero, such an *investment* must be deducted in accordance with Table 10-61(1)B;
 - (b) for a *firm* which has been granted a waiver from *IPRU (INV) 14* : 100%, unless it is:
 - (i) a *material holding* in a *credit* or *financial institution* which would have been included in the scope of consolidation in accordance with rule 14.2.1R if the waiver had not been granted, in which case it must be deducted in full from *original own funds*; or

* for details of counterparty weights see Appendix 47

- (ii) is included in the *firm's trading book*, in which case the *firm* may treat it under the *PRR* rules; or
- (c) for a *firm* which calculates its *financial resources* in accordance with Table 10-62(2)C: 100%, unless the holding is included in the *firm's trading book*, in which case the *firm* may treat it under the *PRR* rules.

Netting

- 10-65 (13)** R A *firm* may offset positive and negative counterparty exposures, calculated in accordance with (8), (9) and (10) above, before it multiplies the residual exposure by the appropriate percentage provided that:
- (a) the exposures arise on transactions with the same counterparty; and
 - (b) the *firm* has a written agreement supported by a legal opinion obtained in accordance with rule 10-64(4).

10-66 LIQUIDITY ADJUSTMENT ON OTHER NON-TRADING BOOK ASSETS

General rule

- 10-66(1)** R A *firm's* total liquidity adjustment on its other *non-trading book* assets which are not *illiquid assets* is the sum of amounts specified as liquidity adjustments below.

Qualifying deposits

- 10-66(2)** R The liquidity adjustment for a *non-trading book qualifying deposit* is 8% of the balance sheet value of the deposit multiplied by the appropriate counterparty weight*, except that there is no liquidity adjustment for amounts due which are secured by *acceptable collateral*.

Loans

- 10-66(3)** R The liquidity adjustment for a loan granted by a *firm* which is due to be repaid within 90 days is 8% of the balance sheet value multiplied by the appropriate counterparty weight*, except that there is no liquidity adjustment for amounts due which are secured by *acceptable collateral*.

Prepayments

- 10-66(4) R** The liquidity adjustment for a prepayment is 8% of the balance sheet value of that prepayment, multiplied by the counterparty weight* appropriate to the third party to whom it has been made, except that there is no liquidity adjustment for amounts due which are secured by *acceptable collateral*.

Other assets

- 10-66(5) R** The liquidity adjustment for *non-trading book* assets other than those specifically stated above where the asset is due to be repaid within 90 days, is 8% of the balance sheet value multiplied by the appropriate counterparty weight*, except that there is no liquidity adjustment for amounts due which are secured by *acceptable collateral*.

Netting

- 10-66(6) R** A *firm* may offset positive and negative counterparty exposures, calculated in accordance with (2), (3) and (4) above, before it multiplies the residual exposure by the appropriate percentage provided that:
- (a) the exposures arise on transactions with the same counterparty; and
 - (b) the *firm* has a written agreement supported by a legal opinion obtained in accordance with rule 10-64(4).

CHARGED ASSETS

General rule

- 10-67 R** A *firm* must calculate the requirement for charged assets as 8% of the aggregate balance sheet value of each asset of the *firm* over which a third party has the right of sale or retention on default by the *firm* multiplied by the appropriate counterparty weight*, except:
- (a) to the extent of any liability of the *firm* plus a reasonable margin in respect of the charged asset;
 - (b) where the asset is collateral for a transaction which is subject to the *CRR* rules;

* for details of counterparty weights, see [Appendix 47](#)

(c) to the extent that the *firm* has calculated a liquidity adjustment or *PRR* in respect of the charged asset.

- G If the *firm* wishes to apply a different approach it will need to seek a modification or waiver from this rule from the *FSA*.

CONTINGENT LIABILITIES

General rule

10-68(1) R A *firm* must calculate a requirement for each of its contingent liabilities arising from *non-trading book* activities as 8% of the value of the *contingent liability* multiplied by the appropriate counterparty weight* except:

- (a) to the extent of any liability of the *firm* plus a reasonable margin in respect of the *contingent liability*; or**
- (b) where the *contingent liability* is collateral for a transaction which is subject to the *CRR* rules.**

- G If the *firm* wishes to apply a different approach it will need to seek a modification or waiver from this rule from the *FSA*.

Note issuance and revolving underwriting facilities

10-68(2) R A *firm* must calculate a requirement for each note issuance and revolving underwriting facility as 4% of the facility multiplied by the appropriate counterparty weight, where:

- (a) The date of commencement of the commitment is the date when the facility agreement becomes legally binding; and**
- (b) The date of the maturity of the commitment is the date of termination of the facility agreement.**

DEFICIENCIES IN SUBSIDIARIES

General rule

10-69 R A *firm* must calculate the requirement for deficiencies in *subsidiaries* as an amount equal to 100% of any deficiency in shareholders' funds at any time of a *subsidiary* of the *firm* except to the extent that:

- (a) provision has already been made by the *firm*; or**

- (b) the *firm* has already calculated a liquidity adjustment or *CRR* because the deficiency arises or partially arises out of a liability of the *subsidiary* to the *firm*.

Financial resources requirement

CALCULATION OF FINANCIAL RESOURCES REQUIREMENT

10-70 R A *firm's financial resources requirement* is the sum of:

- (a) the primary requirement; and
- (b) the secondary requirement.

PRIMARY REQUIREMENT

10-71 R A *firm's primary requirement* is the higher of:

- (a) the sum of its *PRR*, *CRR*, *LER* and base requirement (calculated in accordance with rule 10-72); or
- (b) the *firm's initial capital* requirement for a *category A, B, C or D firm*, calculated in accordance with 10-61(8).

BASE REQUIREMENT

10-72 R A *firm's base requirement* must be calculated in accordance with the following formula:

$$\text{base requirement} = \text{expenditure requirement} \times \left[\frac{\text{expenditure requirement}}{PRR + CRR + LER + \text{expenditure requirement}} \right]$$

10-73 EXPENDITURE REQUIREMENT

General rule

10-73(1) R A *firm's expenditure requirement* must be:

- (a) for a *category D firm* which is not responsible for its counterparties' performance: 6/52nds of its relevant annual expenditure calculated in accordance with (2) to (4) below; or
- (b) for any other *firm*: 1/4 of its relevant annual expenditure calculated in accordance with (2) to (4) below.

Calculation of relevant annual expenditure

10-73(2) R Subject to (3) and (4) below, a *firm* must calculate its relevant annual expenditure with reference to the *firm's* most recent *audited annual financial statements* submitted to the *FSA*, as follows:

- (a) its total revenue; plus
- (b) any loss before taxation;

less the aggregate of the following items:

- (c) profit before taxation;
- (d) *bonuses* paid out of the relevant year's profits and not guaranteed;
- (e) *profit shares* and other appropriations of profit, except for fixed or guaranteed remuneration which is payable even if the *firm* makes a loss for the year;
- (f) paid *commissions shared*, other than to *employees, directors, half commission men or appointed representatives* of the *firm*;
- (g) fees, brokerage and other charges paid to clearing houses, *clearing firms*, exchanges, and *intermediate brokers* for the purposes of executing, registering or clearing transactions;
- (h) interest payable to counterparties;
- (i) interest payable on borrowings to finance the *firm's investment business and associated business*; and
- (j) *exceptional items*, provided that the *firm* first notifies the *FSA* in writing of the nature and amount of the *exceptional items*; and
- (k) losses arising on the translation of foreign currency balances.

Absence of audited annual financial statements

10-73(3) R If a *firm* does not have *audited annual financial statements*, it must:

- (a) where it has just commenced trading or has not been authorised long enough to have submitted *audited annual financial statements* to the FSA (or to the FSA's predecessor), base its relevant annual expenditure on budgeted or other accounts which it submitted to the FSA (or to the FSA's predecessor) as part of the *firm's* application; or
- (b) where its accounts do not represent a 12 month period, calculate relevant annual expenditure on a proportionate basis.

Adjusting relevant annual expenditure

10-73(4) R A firm must adjust its relevant annual expenditure where:

- (a) there has been a significant change in the circumstances or activities of the *firm*; or
- (b) the *firm* has a material proportion of its expenditure incurred on its behalf by third parties and such expenditure is not fully recharged to the *firm*.

G FSA would for example consider an application to vary a *firm's* permitted activity as a significant change.

G The FSA would consider 10% of a firm's expenditure incurred on its behalf by third parties to be material for the purposes of 10-73(4)R.

G If a *firm* is in any doubt, it should always seek guidance from the FSA

10-74 SECONDARY REQUIREMENT

General rule

10-74(1) R A firm must include a secondary requirement in accordance with (2), (3) and (4) below.

Illiquid assets

10-74(2) R A firm which calculates its *financial resources* in accordance with Table 10-62(2)A must calculate a secondary requirement as the higher of:

- (a) an amount equal to 92% of the excess of total *illiquid assets* over 25% of *initial capital* plus interim profit and loss account; and
- (b) an amount equal to 92% of the value of any individual *illiquid asset* which has a value greater than 10% of the *firm's initial capital* plus interim profit and loss account.

G • The following non-trading book investments attract a reduced secondary requirement of 17%

- Gilts, US treasuries, EIB and World Bank securities;
- Listed Equities i.e. stocks that are constituents of the table of constituent indices in Appendix 49;
- London Stock Exchange shares;
- LCH: contributions to the Member Default Fund – Board Notice 352. Secondary Requirement need only be calculated as 92% of the excess of the value of the contribution over the 10% threshold (rule 10-74(2)(b)), as opposed to 92% of the full value of the contribution. (This concession is not a precedent which can be extended to other types of deposit);
- LIFFE seats/shares: reduction only where the seat is unused by the firm or another lessee and is purely held for investment purposes;
- Loans to the extent that the loan is secured by unencumbered acceptable collateral.

Firms may apply for the Secondary Requirement to be reduced, giving reasons why the Secondary Requirement on illiquid assets should be reduced.

Risk profile

10-74(3) R A firm must include in its secondary requirement any amount specified in any requirement to cover an unusual risk profile.

Operational risks

10-74(4) R A firm must include in its secondary requirement any amount specified in any requirement to cover the inadequate management of operational risk to which a firm is exposed.

G In assessing whether to impose a requirement on a firm to cover illiquid assets, risk profile or operational risks, the FSA will consider various criteria. Further detailed guidance is set out in Appendix 48.

POSITION RISK REQUIREMENT

10-80 General principles of PRR

Application

10-80 (1) R A firm must calculate a PRR in respect of all trading book and physical commodities and physical commodities derivatives items.

Obligation to calculate PRR

10-80 (2) R A firm must calculate a minimum PRR as the sum of the minimum PRRs calculated in respect for its positions using:

- (a) the *PRR* calculations contained in the rules and appendices listed in the table below; or
- (b) another method provided the *firm* is able to demonstrate that in all circumstances the calculation being employed results in a higher *PRR* for the position than would be required under (a).

10-120R	CIS PRR
Appendix 4	Interest rate PRR
Appendix 5	Equity PRR & basic interest rate PRR for equity derivatives
Appendix 6	Commodity PRR
Appendix 7	Foreign exchange PRR
Appendix 8	Option PRR

- G A *firm* may seek a modification or a waiver to 10-80(2)R to use a CAD1 model or a VaR model as the basis for calculating part or all of the *PRR* on its positions. For further details on the use of such models see appendices 11 and 12 respectively.
- G Appendix 7 (underwriting) does not contain a *PRR* calculation. Instead, it contains requirements on how to derive the *net underwriting position* or *reduced net underwriting position*. These positions are then included in the relevant *PRR* calculation listed above (i.e. appendix 4, appendix 5, or appendix 9, as well as appendix 8 if the position is denominated in a *foreign currency*).

Frequency of calculation

- 10-80(3)** R **A *firm* must be able to monitor its total *PRR* on an intra-day basis, and, before executing any trade, must be able to re-calculate *PRR* to the level of detail necessary to ensure that the *firm's financial resources requirement* does not exceed the *firm's financial resources*.**

Marking to market

- 10-80(4)** R **A *firm* must *mark to market* its positions, whether or not on the balance sheet, in accordance with rule 10-41(9) at least once every *business day* and more frequently as appropriate.**

Non trading book items

- 10-80(5)** R **Positions in instruments which are *non-trading book* items must be treated under rule 10-65.**

Instruments for which no PRR treatment has been specified

- 10-80(6)** **R** **Where the *firm* has a position in an instrument for which no *PRR* treatment has been specified, it must calculate a *PRR* of an appropriate percentage of the current *mark to market* value of the position and the *firm* must immediately notify the *FSA* of the details of the instrument, the *PRR* calculated and the reasons for the calculation.**

Instruments of non standard form

- 10-80(7)** **R** **Where an instrument is not of a standard form, the *firm* must calculate a *PRR* of an appropriate percentage of the current *mark to market* value of the position and the *firm* must immediately notify the *FSA* of the details of the instrument, the *PRR* calculated and the reasons for the calculation.**

- 10-80(7A) **E** (1) In 10-80(6) and 10-80(7) “an appropriate percentage” is:
- (a) 100%; or
 - (b) a percentage which takes account of the characteristics of the instrument concerned and of discussions with the *FSA* or a predecessor regulator.
- (2) Compliance with (1) may be relied on as tending to establish compliance with 10-80(6) or 10-80(7) as appropriate.
- (3) Contravention of (1) may be relied on as tending to establish contravention of 10-80(6) or 10-80(7) as appropriate.
- G** The methodologies which have been developed assume instruments with standard characteristics. There are many examples, however, of instruments which, although based on a standard contract, contain structural features which make the rules, as stated, inappropriate.

Alternative treatments

- 10-80(8)** **R** **Where a *firm* has the alternative of treating a position under two or more different methods or treatments within methods, it must treat the position under one of those methods.**

10-81
to 10-
111(5) R [deleted]

Collective investment schemes

Eligible collective investment schemes

- 10-120(1) R **A firm must calculate the *PRR* for a position in an *eligible collective investment scheme* as the *mark to market* value of the *firm's* aggregate position multiplied by:**
- (a) **8%, provided that:**
 - (i) **the scheme only invests in *qualifying debt securities* and *qualifying deposits*;**
 - (ii) **the maturities of *qualifying debt securities* does not exceed 2 years; and**
 - (iii) **any right to restrict the withdrawal of funds has not been exercised**
 - (b) **16 % in the case of other *eligible collective investment schemes*.**

Other collective investment schemes

- 10-120(2) R (a) **A firm must calculate the *PRR* for a position in any other *collective investment scheme* as the *mark to market* value of the *firm's* aggregate position multiplied by 16%, provided that:**
- (i) **100% of the scheme funds are invested in liquid and readily realisable securities which are *marketable investments* or held in cash;**
 - (ii) **the *firm* knows the underlying constituents of the scheme on a daily basis;**
 - (iii) **shares or units can be created or redeemed in exchange for underlying constituents;**
 - (iv) **investment in the scheme results in an equivalent or higher *PPR* than the underlying constituents would attract if directly held; and**

(v) any right to restrict the withdrawal of funds has not been exercised.

(b) A firm must calculate the *PRR* for a position in any other *collective investment scheme* as the *mark to market* value of the *firms* aggregate position multiplied by 100%

G For the purposes of 10-120(1)(a), the scheme may invest in other financial instruments but for hedging purposes only.

10-130
to 10-
169B(3)

[deleted]

Counterparty Risk Requirement

10-170 General principles of CRR

General rule

10-170 (1) R **A firm must calculate its total *CRR* on counterparty *exposures* arising from its *trading book* business and its *physical commodities* business as the sum of all the amounts calculated in accordance with the rules referred to in the table below.**

R **TABLE 10-170(1) - Counterparty risk requirement**

Rules	
10-171	Cash against documents transactions
10-172	Free deliveries of physical commodities and securities
10-173	Repurchase and reverse repurchase, securities lending and borrowing and sale and buy back agreements
10-174	Derivative transactions
10-175	Other amounts owed to a firm arising out of trading book business
10-176	Trading book deposits

10-170 (2) R **A firm must calculate *CRR* on a counterparty exposure arising from the *trading book* of another undertaking which the *firm* has guaranteed as a counterparty exposure of the *firm* itself.**

Frequency of calculation

10-170 (3) R **A firm:**

(a) **must calculate its *CRR* at least once each *business day*;**

- (b) **must, before executing any transaction, be able to re-calculate *CRR* to the level of detail necessary to ensure that the *firm's financial resources requirement* does not exceed the *firm's financial resources*; and**
- (c) **may for the purposes of the relevant calculations, use prices of *investments* and *physical commodities* as at the close of business on the previous day.**

Negative amounts

- 10-170 (4) R A *firm* must not include any *CRR* if it is a negative amount.**

Instruments for which no *CRR* has been specified

- 10-170 (5) R Where a *firm* is in doubt as to the classification of an item for the purposes of *CRR*, it must add to its *CRR* an appropriate part of the counterparty exposure on the item concerned, and must immediately notify the *FSA* of the instrument or transaction, the counterparty and the treatment the *firm* adopts.**

Instruments of non standard form

- 10-170 (6) R Where an instrument is not of a standard form, a *firm* must add to its *CRR* an appropriate part of the counterparty exposure on the item concerned, and must immediately notify *the FSA* of the instrument or transaction, the counterparty and the treatment the *firm* adopts.**

- G The methodologies which have been developed assume instruments with standard characteristics. There are many examples, however, of instruments which, although based on a standard contract, contain structural features which make the rules, as stated, inappropriate. Examples of such instruments are (i) path dependent and other exotic *options*, (ii) *swaps* with cash flows subject to a multiplier, (iii) *securities* with embedded *options*. In such circumstances a *firm* should consult the *FSA*. Where a *firm* is in any doubt, it should always seek guidance from the *FSA*.

- 10-170(6A) E (1) In 10-170(5) or 10-170(6) “an appropriate part” is:
- (a) the whole; or
 - (b) a proportion which takes account of the characteristics of the transaction and the counterparty concerned, and of discussions with the *FSA* or a predecessor regulator.
- (2) Compliance with (1) may be relied on as tending to establish compliance with 10-170(5) or 10-170(6) as appropriate.

- (3) Contravention of (1) may be relied on as tending to establish contravention of 10-170(5) or 10-170(6) as appropriate.

Provisions

- 10-170 (7) R A *firm* may reduce the counterparty exposure on which its *CRR* is calculated to the extent that it makes provision for a counterparty balance.**

Connected companies

- 10-170 (8) R For the avoidance of doubt, a *firm* must calculate a *CRR* as appropriate on counterparty exposures to or from *connected companies*.**

Basis of valuation

- 10-170 (9) R For the purposes of valuing instruments and *physical commodities* at *mark to market* value in the calculation of *CRR*, a *firm* must be consistent in the basis it chooses and may use either mid market value or bid and offer prices (as appropriate).**

Netting

- 10-170 (10) R A *firm* which has offsetting exposures in similar types of transactions with a counterparty may offset these in accordance with rules 10-171(4), 10-172 (5), 10-173(10), 10-174(6) and 10-175(4) when calculating *CRR* if it has a contractual netting agreement with that counterparty, which:**
- (a) covers the transactions which the *firm* is seeking to net;**
 - (b) creates a single obligation in each currency or a single overall obligation to pay (or receive) a net sum of cash in the event of default, bankruptcy, liquidation or similar circumstances;**
 - (c) does not include a *walkaway clause*; and**
 - (d) is supported by written and reasoned independent legal opinions to the effect that, in the event of a legal challenge, the relevant courts would find the *firm's* exposure to be the single net amount mentioned in (b) above.**

G Legal opinions should relate to:

- (a) the law of the jurisdictions in which the counterparty is organised;
- (b) the law of the jurisdiction in which any branch involved is located;

- (c) the law that governs the agreement and, if different the law that governs individual transactions pursuant to it; and
 - (d) the law that governs the legal status of the counterparty who is entering into transactions of the type which the *firm* is seeking to net.
- G Where a *firm* uses a standard netting agreement and the netting/set-off clauses therein follow the form of that standard agreement, provided a legal opinion has already been obtained on the standard agreement which addresses the capacity of counterparties of the type with which the *firm* wishes to contract, that may be relied upon.
- G Legal opinions on netting agreements should be obtained from independent legal advisers with sufficient expertise and experience in this area of law. Opinions from in-house counsel will not be acceptable.
- G Where the regulator of the counterparty is not satisfied that the netting agreement is enforceable under its laws, the netting agreement cannot be relied upon regardless of the opinions obtained by the *firm*.

10-171 Cash against documents transactions

General rule

10-171 (1) R **A *firm* which enters into a transaction on a cash against documents basis must calculate the counterparty exposure for transactions still unsettled 5 business days after settlement day as set out in (3) below and must then multiply this by the appropriate percentage set out in the table below to calculate a CRR for each separate unsettled transaction.**

R **TABLE 10-171(1) – Percentage to be applied to the counterparty exposure**

Business days after settlement day	Percentage
0-4	Nil
5-15	8%
16-30	50%
31-45	75%
46 or more	100%

Collateral

10-171 (2) R **A *firm* may reduce the counterparty exposure on which its CRR is calculated to the extent that it holds *acceptable collateral* to cover that exposure.**

Counterparty exposure

- 10-171 (3)** **R** **(a)** Where a *firm* has neither delivered *securities* or *physical commodities* nor received payment when purchasing *securities* or *physical commodities* for, or selling *securities* or *physical commodities* to, a counterparty, the positive counterparty exposure is the excess of the contract value over the market value of the *securities* or *physical commodities*.
- (b)** Where a *firm* has neither received *securities* or *physical commodities* nor made payment when selling *securities* or *physical commodities* for, or purchasing *securities* or *physical commodities* from, a counterparty, the positive counterparty exposure is the excess of the market value over the contract value of the *securities* or *physical commodities*.

Netting

- 10-171 (4)** **R** A *firm* may offset positive and negative counterparty exposures, calculated in accordance with (3) above, before it multiplies the residual exposure by the appropriate percentage in Table 10-171(1) provided that:
- (a)** the exposures arise on transactions with the same counterparty; and
- (b)** the *firm* has a written agreement supported by a legal opinion obtained in accordance with rule 10-170(10).

Sub-total

- 10-171 (5)** **R** The sum of the amounts calculated in accordance with (1) to (4) above is the *firm's* total *CRR* for cash against documents transactions.

10-172 Free deliveries of physical commodities and securities

General rule

- 10-172 (1)** **R** When a *firm* makes delivery to a counterparty of *physical commodities* or *securities* without receiving payment or pays for *physical commodities* or *securities* without receiving the *physical commodities* or *securities*, the *firm* must calculate *CRR* for each such *free delivery* in accordance with (2), to (6) below.

Collateral

10-172 (2) R A *firm* may:

- (a) reduce the counterparty exposure on which its *CRR* is calculated to the extent that it holds *acceptable collateral* to cover that exposure; and
- (b) where it does not have an *ACMP*, may continue to multiply the counterparty exposure by 8% multiplied by the counterparty weight, to the extent that the *firm* holds *adequate collateral* to cover that exposure.

Counterparty exposure

10-172 (3) R A *firm* must calculate the counterparty exposure for each *free delivery* as set out below and multiply this amount by the appropriate percentage in Table 10-172(2) as follows:

- (a) if the *firm* has delivered *physical commodities* or *securities* to a counterparty and has not received payment, the counterparty exposure is the full amount due to the *firm* (i.e. the contract value);
- (b) if the *firm* has made payment to a counterparty for *physical commodities* or *securities* and not received them, the counterparty exposure is the *mark to market* value of the *physical commodities* or *securities* respectively.

R TABLE 10-172(3) - Percentage to be applied to counterparty exposures relating to free deliveries

Nature of counterparty to whom counterparty exposure exists	Business days since delivery			
	0-15	16-30	31-45	46 or more
A counterparty granted a credit line under an <i>ACMP</i>	8% x counterparty weight.			
A counterparty not granted a credit line under an <i>ACMP</i>	8% x counterparty weight*	50% x counterparty weight*	75% x counterparty weight*	100%

Cross border deliveries

- 10-172 (4) R** If settlement of the transaction is effected across a national border, the *firm* will be granted a window of one *business day* from the time of payment or delivery, during which the appropriate percentage will be zero.

Netting

- 10-172 (5) R** A *firm* may reduce the counterparty exposure for a transaction calculated in accordance with (2) above, before it multiplies the residual exposure by the appropriate percentage in Table 10-172(2), by:
- (a) the value of any free payment received from the counterparty; or
 - (b) the contract value of any *physical commodities* or *securities* received free from the counterparty,
- provided that:
- (c) the exposures arise on transactions with the same counterparty; and

* for details of counterparty weights see **Appendix 47**

(d) the *firm* has a written agreement supported by a legal opinion obtained in accordance with rule 10-170(10).

Sub-total

10-172 (6) R The sum of the amounts calculated in accordance with (2) to (5) above is the *firm's* total *CRR* for *free deliveries* of *physical commodities* and *securities*.

10-173 Repurchase and reverse repurchase, securities or physical commodities lending and borrowing and sale and buy back agreements
General rule

10-173 (1) R Where a *firm* has entered into any *repurchase, reverse repurchase, securities or physical commodities* lending, *securities or physical commodities* borrowing, *sale and buy back* or *buy and sale back agreement, undocumented sale and buy back* or *undocumented buy and sale back agreement*, it must calculate a *CRR* for each such agreement in accordance with (2) to (11) below.

Counterparty exposure

10-173 (2) R The counterparty exposure for:

(a) any *repurchase, securities or physical commodities* lending or *sale and buy back* or *undocumented sale and buy back agreement* in respect of *securities or physical commodities* is the excess of the *mark to market* value of the *securities or physical commodities* over the value of *adequate collateral* under the agreement, if the net figure is positive; and

(b) any *reverse repurchase, securities or physical commodities* borrowing *buy and sale back* or *undocumented buy and sale back agreement* in respect of *securities or physical commodities* is the excess of the amount paid or collateral given for the *securities or physical commodities* over the *mark to market* value of the *securities or physical commodities* received under the agreement, if the net figure is positive.

G The *securities or physical commodities* received can be included only where they are held under the control of the *firm* or where they were delivered into the control of the *firm* upon initiation of the agreement.

Percentages

- 10-173 (3)** R **A firm must calculate CRR:**
- (a) where the counterparty is granted a credit line under an *ACMP* as 8% multiplied by the counterparty weight*, multiplied by the counterparty exposure; and
 - (b) where the counterparty is not granted a credit line under an *ACMP* as 8% multiplied by the counterparty weight*, multiplied by the counterparty exposure except where the counterparty exposure is greater than:
 - (i) 5% of the value of the *securities* where the *securities* are *qualifying debt securities*; or
 - (ii) 10% of the value of the *securities* or *physical commodities* where they are any other *securities* or *physical commodities*,
- in which case the *firm* must in addition calculate a *CRR* of 100% of the excess of the counterparty exposure over these limits.

Additional CRR

- 10-173 (4)** R **Where a firm has entered into an *undocumented buy and sale back agreement* or an *undocumented sale and buy back agreement*, it must calculate an additional *CRR* equal to the *CRR* calculated in accordance with (3) above.**

Margin percentages

- 10-173 (5)** R **A firm may opt to calculate the *CRR* in (3)(b) above using the lower margin percentage (5%) in order to avoid undue complication.**

Mark to market value

- 10-173 (7)** R **For the purposes of this rule, the current *mark to market* value of *securities* and the value of cash lodged must include accrued interest.**

Daily valuation

- 10-173 (8)** R **A firm must *mark to market* collateral and *securities* or *physical commodities* lent or sold, or borrowed or purchased, at least daily.**

* for details of counterparty weights, see **Appendix 47**

Additional adequate collateral

- 10-173 (9)** R Where the *firm* has called for additional *adequate collateral* from the other party to the agreement and the counterparty exposure exceeds the margin limits in (3)(b) above, a *firm* may calculate a *CRR* as if the margin limit had not been exceeded for no more than one *business day*.

Netting

- 10-173 (10)** R Where a *firm* has a portfolio of *repurchase, reverse repurchase, securities or physical commodities* lending, *securities or physical commodities* borrowing, *sale and buy back* and *buy and sale back agreements* which it has entered into with the same counterparty, it may calculate the counterparty exposure on those transactions as the total of all *securities or physical commodities* and cash lent or given as collateral to the counterparty less the total of all *securities or physical commodities* and cash received from the counterparty, provided that the *firm* has a written agreement supported by a legal opinion obtained in accordance with rule 10-170(10).

Sub-total

- 10-173 (11)** R The sum of the amounts calculated in accordance with this rule is the total *CRR* for *repurchase and reverse repurchase, securities or physical commodities* lending and borrowing *sale and buy back* and *undocumented sale and buy back agreements*.

10-174 Derivative transactions

General rule

- 10-174 (1)** R A *firm* must calculate for each *derivative* transaction a *CRR* by multiplying the counterparty exposure calculated in accordance with (2) and (3) below, by the appropriate percentage in Table 10-174(5) below.

Collateral

- 10-174 (2)** R A *firm* may:
- (a) reduce the counterparty exposure on which its *CRR* is calculated to the extent that it holds *acceptable collateral* to cover that exposure; and

- (b) where it does not have an *ACMP*, may continue to multiply the counterparty exposure by 8% multiplied by the counterparty weight, to the extent that the *firm* holds *adequate collateral* to cover that exposure.

Counterparty exposure

10-174 (3) R A *firm* must calculate the counterparty exposure on *derivative* transactions in accordance with either (a), (b) or (c) below:

- (a) where a counterparty has not fully paid a *margin requirement* on a *derivative* transaction listed on an *exchange* or cleared through a clearing house, or met it through the deposit of *acceptable collateral* not otherwise used, a *firm* must calculate the counterparty exposure as the shortfall;
- (b) where a *firm* sells or writes an *option* to a counterparty or buys an *option* on behalf of a counterparty and the counterparty has not paid the full *option* premium, or met it through the deposit of *acceptable collateral* not otherwise used, it must calculate the counterparty exposure as the uncovered premium on the transaction; or
- (c) a *firm* must calculate the counterparty exposure arising from a *derivative* transaction other than a written or sold *option* or a *derivative* transaction listed on an *exchange* or cleared through a clearing house, as the credit equivalent amount calculated in accordance with Table 10-174(3), not covered by the deposit of *acceptable collateral* not otherwise used.

R Table 10-174(3A) – Method of calculating credit equivalent amount

Type of derivative transaction	Credit equivalent amount	
	If A is positive	If A is negative
Interest rate swaps: single currency		
(a) floating rate swapped against floating rate	A	nil
(b) fixed rate swapped against floating rate:		
- under one year to maturity	A	nil
- over one year to five years	A + 0.5% of N	0.5% of N
- over five years	A + 1.5% of N	1.5% of N
Cross-currency interest rate swaps		
- under one year to maturity	A + 1% of N	1% of N
- over one year to five years	A + 5% of N	5% of N
- over five years	A + 7.5% of N	7.5% of N
Other interest rate contracts*		
- under one year to maturity	A	nil
- over one year to five years	A + 0.5% of N	0.5% of N
- over five years	A + 1.5% of N	1.5% of N
Foreign exchange and gold contracts*		
- exchange rate contracts with an original maturity of 14 days or less	nil	nil
- under one year to maturity	A + 1% of N	1% of N
- over one year to five years	A + 5% of N	5% of N
- over five years	A + 7.5% of N	7.5% of N
Equity contracts*		
- under one year to maturity	A + 6% of N	6% of N
- over one year to five years	A + 8% of N	8% of N
- over five years	A + 10% of N	10% of N
Precious metal (not gold) contracts*		
- under one year to maturity	A + 7% of N	7% of N
- over one year to five years	A + 7% of N	7% of N
- over five years	A + 8% of N	8% of N
Commodity contracts*		
- under one year to maturity	A + 10% of N	10% of N
- over one year to five years	A + 12% of N	12% of N
- over five years	A + 15% of N	15% of N

Notes

* *FRAs, swaps, futures, purchased options, and other contracts for differences*

A = the replacement cost of the contract

N = the notional or actual principal amount or value underlying the contract

For contracts with multiple exchanges of principal, the % of N has to be multiplied by the remaining number of payments still to be made according to the contract.

In the case of a derivative referenced on a bond which satisfies the criteria for a *qualifying debt security*, the %N applicable to interest rate derivatives may be utilised to calculate the credit equivalent amount. For a derivative referenced on a 'non-qualifying' bond, the credit equivalent amount must be calculated with reference to the %N applicable to equity derivatives.

For contracts that are structured to settle outstanding exposure following specified payment dates and where the terms are reset such that the market value of the contract is zero on these specified dates, the residual maturity would be equal to the time until the next reset date. In the case of interest-rate contracts that meet these criteria and have a remaining maturity of over one year, the percentage is no lower than 0.5%.

If a firm uses the modified maturity ladder approach to calculate *PRR* under 30R of appendix 6, it may use Table 10-174(3B).

R Table 10-174(3B) – Method of calculating credit equivalent amount for commodities

Type of derivative transaction*	Credit equivalent amount	
	If A is positive	If A is negative
Precious metals (except gold)		
- under one year to maturity	A + 2% of N	2% of N
- over one year to five years	A + 5% of N	5% of N
- over five years	A + 7.5% of N	7.5% of N
Base metals		
- under one year to maturity	A + 2.5% of N	2.5% of N
- over one year to five years	A + 4% of N	4% of N
- over five years	A + 8% of N	8% of N
Softs (agricultural)		
- under one year to maturity	A + 3% of N	3% of N
- over one year to five years	A + 5% of N	5% of N
- over five years	A + 9% of N	9% of N
Other commodity		
- under one year to maturity	A + 4% of N	4% of N
- over one year to five years	A + 6% of N	6% of N
- over five years	A + 10% of N	10% of N
Notes		
<p><i>FRAs, swaps, futures, purchased options, and other contracts for differences</i></p> <p>A = the replacement cost of the contract</p> <p>N = the notional or actual principal amount or value underlying the contract</p> <p>For contracts with multiple exchanges of principal, the % of N has to be multiplied by the remaining number of payments still to be made according to the contract.</p> <p>In the case of a derivative referenced on a bond which satisfies the criteria for a <i>qualifying debt security</i>, the %N applicable to interest rate derivatives may be utilised to calculate the credit equivalent amount. For a derivative referenced on a 'non-qualifying' bond, the credit equivalent amount must be calculated with reference to the %N applicable to equity derivatives.</p> <p>For contracts that are structured to settle outstanding exposure following specified payment dates and where the terms are reset such that the market value of the contract is zero on these specified dates, the residual maturity would be equal to the time until the next reset date. In the case of interest-rate contracts that meet these criteria and have a remaining maturity of over one year, the percentage is no lower than 0.5%.</p>		

Sums due for payment or owed on closed out derivative transactions

10-174 (4) R When a counterparty has not fully met amounts owed to a *firm* arising out of losses on closed out *derivative* transactions through the deposit of *acceptable collateral* not otherwise used, or has not fully settled amounts owed in respect of periodic or final settlement of transactions, a *firm* must calculate *CRR* equal to the unpaid loss multiplied by the appropriate percentage from the Table 10-174(5) below.

10-174 (4A) R In the case of a failed FX transaction (whether originally contracted for *forward* settlement, or undertaken in the spot market) where the *firm* has released funds to its counterparty, but has not received the funds in the alternative currency, the *CRR* must be calculated as the gross value of the funds not received, multiplied by the appropriate percentage from Table 10-174(5) below.

CRR percentages

10-174 (5) R A *firm* must multiply the counterparty exposure by the appropriate percentage from the table below, but:

- (a) may opt to calculate *CRR* using the highest available credit percentage in the table below in order to avoid undue complication; and
- (b) may reduce the counterparty weight applicable to counterparty exposures calculated in accordance with (3)(c) above to 50%, where the counterparty would normally attract a counterparty weight of 100% in accordance with Appendix 47.

R TABLE 10-174(5) - CRR percentages

Type of Contract	Nature of counterparty to whom counterparty exposure exists	Business days after counterparty exposure first occurred	
		0 - 5	6 or more
Failed FX Transaction	Any	8% x counterparty weight*	100%
Other	A counterparty granted a credit line under an <i>ACMP</i>	8% x counterparty weight*	
	A counterparty not granted a credit line under an <i>ACMP</i>	8% x counterparty weight*	100%

Netting

10-174 (6) R A firm may offset counterparty exposures arising on *derivative* transactions calculated in accordance with (2), (3) and (4) above before it multiplies the residual exposure by the appropriate *CRR* percentage as follows:

- (a) variation margin payable to a counterparty against an initial *margin requirement* or variation *margin requirement* receivable from a counterparty;
- (b) variation margin payable to a counterparty against a positive “A” as calculated in accordance with Table 10-174(3A);
- (c) a negative “A” as calculated in accordance with Table 10-174(3A) against an initial *margin requirement* or variation *margin requirement* receivable from a counterparty;
- (d) a negative “A” against a positive “A” in each case as calculated in accordance with Table 10-174(3A);
- (e) loss on a closed out *derivative* transaction which has not been settled against variation margin payable to a counterparty;
- (f) loss on a closed out *derivative* transaction which has not been settled against negative “A” calculated in accordance with Table 10-174(3A);

* for details of counterparty weights, see Appendix 47

- (g) profit on a closed out *derivative* transaction which has not been settled against an initial *margin requirement* or variation *margin requirement* receivable from a counterparty;
- (h) profit on a closed out *derivative* transaction which has not been settled against a loss on a closed out *derivative* transaction;
- (i) profit on a closed out *derivative* transaction which has not been settled against a positive "A" as calculated in accordance with Table 10-174(3A);
- (j) premium receivable in respect of written *options* against variation margin payable, initial margin payable or a closed out profit payable to the counterparty or a negative "A" as calculated in accordance with Table 10-174(3A);
- (k) where the *firm* has received the premium due for a written *option*, a negative "A" (the replacement cost) for the written *option* against a positive "A" in each case as calculated in accordance with Table 10-174(3A); or
- (l) in the case of *perfectly matched contracts* these may be treated as a single contract with a notional principal equivalent to the net receipts; or
- (m) where transactions are subject to (3)(c) above, the potential future credit exposures (PFCE) on transactions with the same counterparty (i.e. % o N) may be netted in accordance with Table 10-174(6) below,

provided that:

- (i) the exposures arise on transactions with the same counterparty; and
- (ii) the *firm* has a written agreement, supported by a legal opinion obtained in accordance with rule 10-170(10).

Table 10-174(6)

The netted PFCE is the sum of:	
step one	40% of gross PFCE
step two	60% of gross PFCE multiplied by the net-to-gross ratio (NGR)
<p>Notes:</p> <p>NGR = $\frac{\text{(net replacement cost)}}{\text{(gross replacement cost)}}$</p> <p>The NGR must be calculated on all contracts included in a legally valid bilateral netting agreement with a given counterparty.</p>	

Equivalent contracts

- 10-174 (7) R** Rule 10-174(3)(c) also applies to contracts, which, although they are listed on an exchange are fully dependent upon the issuer for performance (e.g. covered warrants).

Sub-total

- 10-174 (8) R** The sum of the amounts calculated in accordance with this rule is the *firm's CRR for derivative transactions*.

- 10-175** Other amounts owed to a firm arising out of trading book business

General rule

- 10-175 (1) R** A *firm* must calculate for each other amount owed arising out of *trading book* business a *CRR* by multiplying the counterparty exposure by the appropriate percentage in Table 10-175(4).

Collateral

- 10-175 (2) R** A *firm* may:
- (a) reduce the counterparty exposure on which its *CRR* is calculated to the extent that it holds *acceptable collateral*, to cover that exposure; and
 - (b) where it does not have an *ACMP*, may continue to multiply the counterparty exposure by 8% multiplied by the counterparty weight, to the extent that the *firm* holds *adequate collateral* to cover that exposure.

Counterparty exposure

- 10-175 (3) R** The counterparty exposure for an other amount owed to a *firm* arising out of *trading book* business is the balance sheet value.

CRR percentages

- 10-175 (4) R** A *firm* must multiply the counterparty exposure by the appropriate percentage from the table below, except that accrued interest or accrued dividends on *trading book investments* shall be subject to a **CRR** of 8% multiplied by the counterparty weight until the counterparty exposure has been outstanding for more than 15 *business days* after the date that it was due to be received, after which the percentage will increase in accordance with Table 10-175(4).

R TABLE 10-175(4) - CRR percentages

Nature of counterparty to whom counterparty exposure exists	Business days after counterparty exposure first recorded in accounts			
	0-15	16-30	31-45	46 or more
A counterparty granted a credit line under an <i>ACMP</i>	8% x counterparty weight*			
A counterparty not granted a credit line under an <i>ACMP</i>	8% x counterparty weight*	50% x counterparty weight*	75% x counterparty weight*	100%

Netting

- 10-175 (5) R** A *firm* may reduce the value of the amounts owed to the *firm* by an amount owed by the *firm* to a counterparty before it multiplies this by 100% provided that:
- (a) the exposures arise with the same counterparty; and
 - (b) the *firm* has a written agreement supported by a legal opinion obtained, in accordance with rule 10-170(10).

* For details of counterparty weights, see Appendix 47

Sub-total

- 10-175 (6)** R **The sum of the amounts calculated in accordance with this rule is the *CRR* for other amounts owed to a *firm* arising out of *trading book* business.**

Trading book qualifying deposits

- 10-176** R **A *firm* must calculate a *CRR* for a *trading book qualifying deposit* as 8% of the value of the deposit multiplied by the appropriate counterparty weight, except that there is no *CRR* for deposits which are secured by *acceptable collateral*.**

LARGE EXPOSURES REQUIREMENT

- 10-190** General principles of LER

Application

- 10-190 (1)** R **A *firm* must comply with rules 10-190 to 10-195 on both a solo and consolidated basis, except that a *firm* with a waiver from consolidated supervision in accordance with rule 14.1.4R or which is exempt under rule 14.1.2R, must comply with rules 10-190 to 10-195 on a solo basis only and also with rule 10-196.**

General rule

- 10-190 (2)** R **A *firm* must calculate its total *LER* on all *exposures* to third parties and *groups of connected third parties* arising from its *trading book* and *non-trading book* business, in accordance with rules 10-190 to 10-195, excluding:**
- (a) *exposures* connected with foreign *exchange* transactions incurred in the ordinary course of settlement during the two *business days* following due payment date; and**
 - (b) *exposures* in connection with transactions for the purchase or sale of *securities* incurred in the ordinary course of settlement during the five *business days* following and including due payment date or due delivery of the *securities*, where neither cash nor *securities* have been delivered.**

Frequency of calculation

10-190 (3) R **A firm must be able to calculate its LER at least once each day and before executing any transaction be able to re-calculate it to the level of detail necessary to ensure that the firm's financial resources requirement does not exceed the firm's financial resources.**

Exposures to connected third parties

10-190 (4) R **Exposures to a group of connected third parties must be aggregated and treated as if they are a single exposure.**

Trustee

10-190 (5) R **Transactions entered into by a firm as trustee are excluded from the scope of LER.**

10-191 Types of exposure

General

10-191 (1) R **For the purposes of rules 10-190 to 10-195 and 10-32(3) to (7), "exposure" includes any trading book issuer exposure, trading book counterparty exposure and non-trading book exposure, except where explicitly exempt elsewhere in those rules.**

G A transaction could result in both issuer and a counterparty exposure.

Trading book issuer exposure

10-191 (2) R **A trading book issuer exposure is the market value of the net long position, taking account of all actual and notional long and short positions, in either debt or equity instruments including any underlying derivatives, convertibles and warrants issued by a third party which are held in the firm's trading book.**

10-191 (3) R **A trading book issuer exposure for a derivative should be determined with reference to the underlying notional securities position in accordance with (a) to (j) below.**

Futures, forwards and FRAs

(a) A future or forward on a government security or an interest rate does not generate an issuer exposure.

(b) An FRA does not generate an issuer exposure.

(c) A future or forward on a corporate debt security or individual equity is treated as an exposure to the underlying issuer.

Interest rate, foreign currency and equity swaps

- (d) **An interest rate or currency swap does not generate an issuer exposure.**
- (e) **An interest rate leg of an equity swap does not generate an issuer exposure.**
- (f) **Where the equity leg of an equity swap is based on the change in value of an individual equity, it is treated as an exposure to the issuer of the equity.**

Indices/baskets

- (g) **Where a future on an index, an equity swap based on an index or basket of securities, or any other index-linked derivative is broken down into its constituents by a firm for the purposes of calculating PRR, an issuer exposure is generated for each underlying constituent position.**

G Any issuer exposure to a credit or financial institution which arises as a result of rule 10-191(3)(g) should be included within the calculation required under rule 10-61(7), (material holdings in credit and financial institutions).

- (h) **Where a future on an index, an equity swap based on an index or basket of securities, or any other index-linked derivative is not broken down into its constituents by a firm for the purposes of calculating PRR, the basket or index position does not generate an issuer exposure.**

Options

- (i) **An option or warrant on an individual corporate debt security or equity that is in the money must be treated as an exposure, at the full value of the underlying (i.e. at a delta of 1), to the issuer of the underlying instrument, unless the firm has an approved model in which case the firm may use the delta-weighted value of the underlying generated by the model.**
- (j) **An out of the money option or warrant must not be treated as an exposure.**

Trading book counterparty exposure

- 10-191 (4) R A trading book counterparty exposure is calculated in accordance with rules 10-170 to 10-176 before applying the appropriate CRR percentage.**

Calculation of net counterparty exposure

- 10-191 (5)** R Where, in accordance with rules 10-170 to 10-176, net counterparty *exposures* are used for the purposes of calculating *CRR*, the net *exposure* may be used for rules 10-190 to 10-196 and rule 10-32(3) to (7), and the maturity of the net *exposure* is deemed to be the same as that of the underlying positive *exposure* with the longest maturity.

Non-trading book exposure

- 10-191 (6)** R (a) The *non-trading book* counterparty *exposure* of a *firm* is the amount at risk, before applying counterparty weights, arising from the *non-trading book* assets calculated in accordance with rules 10-65 to 10-69.
- (b) The *non-trading book* issuer risk is the full market value of the underlying *exposure*.

10-192 Exposures exempt from LER

Exempt exposures

- 10-192 (1)** R A *firm* may exclude the following from its *LER* calculation and the limits set out in rule 10-193:
- (a) *exposures* to or guaranteed by *Zone A* central governments or central banks;
 - (b) *exposures* to or guaranteed by the *European Communities*;
 - (c) *exposures* to *Zone B* central governments or central banks denominated in the national currency of the third party;
 - (d) *exposures* secured by *securities* issued by *Zone A* central governments or central banks, the *European Communities* or an *EEA* regional government or *local* authority which represents no higher a risk than its central government;
 - (e) *exposures* secured by cash deposited with the *firm* or its *connected credit institution*;
 - (f) *exposures* secured by CDs issued by the *firm* or its *connected credit institution* and deposited with one of them;
 - (g) if the *firm* first notifies the *FSA* in writing, *exposures* to the *firm's* *parent*, *subsidiaries* and other *subsidiaries* of its *parent*, provided that these entities are subject to consolidated supervision in accordance with *IPRU (INV) 14*;

- (h) **exposures with a residual maturity of one year or less to counterparties which are not *connected companies* and which are *credit institutions, investment firms, recognised third country investment firms, recognised clearing houses and recognised exchanges* on which *financial instruments* are traded, not constituting their own funds;**
- (i) **asset items constituting claims on and other *exposures* to those institutions which are not *credit institutions* but which are regulated institutions operating in the inter-bank and public debt markets, with a maturity of one year or less, and secured with *acceptable collateral*;**
- (j) ***exposures* secured by *securities*, provided that:**
 - (i) **the *securities* were not issued by the *firm* or a member of its group;**
 - (ii) **the *securities* were not issued by the third party to which the *exposure* arises;**
 - (iii) **the *securities* are *marked to market*;**
 - (iv) **the *securities* are traded on a stock exchange or are freely transferable with prices regularly quoted in trading between market professionals;**
 - (v) **the *mark to market* value of the *securities* is at least 200% of the value of the *exposure* secured except that where the *securities* are:**
 - (aa) ***shares*, the *mark to market* value of the *securities* must be at least 250% of the value of the *exposure* secured; and**
 - (bb) **debt *securities* issued by a *credit institution* (which do not constitute its *financial resources*), *EEA* regional government or local authority which does not represent the same risk as its central government, a *multilateral development bank*, the *mark to market* value of the *securities* must be at least 150% of the value of the *exposure* secured;**
- (k) ***material holdings* in *credit institutions* and *financial institutions* which have been deducted from *financial resources* in accordance with rule 10-61(7);**
- (l) ***exposures* where the *firm* has already incurred a 100% *PRR, CRR* or liquidity adjustment.**

- (m) **exposures consisting of debt securities to *multilateral development banks*;**
- (n) **if the *firm* first notifies the *FSA* in writing, exposures with a residual maturity of one year or less to counterparties which are connected to the *firm* and which are *credit institutions, investment firms, recognised third country investment firms, recognised clearing houses* and *recognised exchanges* on which *financial instruments* are traded, not constituting their own funds.**

G Any part of an *exposure* that is partially covered by collateral, as defined in rules 10-192(1)(d), (e), (f) and (j), is exempt from *LER*.

Optional exemption

10-192
(2)

- R Where a *firm* has exposures to unconnected *credit institutions, investment firms, recognised third country investment firms, recognised clearing houses, and recognised exchanges* on which *financial instruments* are traded, not constituting those third parties' own funds, it may elect either to:**
- (a) **disregard exemption 10-192(1)(h) above and exclude 80% of all such exposures regardless of maturity; or**
 - (b) **exclude all exposures with a maturity of one year or less, 80% of those exposures with a maturity of between one and three years and, in the case of marketable debt securities, 50% of those exposures with a maturity of more than three years.**
 - (c) **if the *firm* first notifies the *FSA* in writing, the election in (a) or (b) above may be made with regard to exposures to counterparties which are connected to the *firm* and which are *credit institutions, investment firms, recognised third country investment firms, recognised clearing houses, and recognised exchanges* on which *financial instruments* are traded, not constituting those third parties' own funds.**

G A *firm* should be consistent across all products in its application of (a) and (b) above.

Partially exempt exposures

- 10-192 (3)** **R** **A firm may reduce the exposures in its LER calculation as follows:**
- (a)** **to the extent that an exposure to a counterparty is unconditionally guaranteed by a third party or parent, a firm may treat that part of the exposure as having been incurred to the third party or parent rather than to the counterparty, having given prior written notice to the FSA;**
 - (b)** **by 80%, exposures to or guaranteed by an EEA regional or local authority;**
 - (c)** **undrawn credit facilities to the extent that an agreement has been concluded with the third party or group of connected third parties under which the exposure may be incurred only where it will not cause the firm to exceed the LER limits.**
- G** The exempt exposures detailed in rule 10-192 do not apply to the quarterly reporting of large exposures (see SUP 16).
- 10-193** Limits for trading book and non-trading book exposures
- 10-193 (1)** **R** **A firm's non-trading book large exposures must not individually exceed 25% of own funds as specified in Table 10-61(1)B.**
- 10-193 (2)** **R** **A firm's non-trading book large exposure to any third party connected to the firm, which is not exempt under rule 10-192(1)(g), must not exceed 20% of own funds as specified in Table 10-61(1)B, unless the firm has notified the FSA under rule 10-32(3)(b).**
- 10-193 (3)** **R** **A firm's aggregate non-trading book large exposures must not exceed 800% of own funds.**
- G** A firm's trading book large exposures may individually exceed 25% of financial resources provided that all non-trading book large exposures to the same third party are within the limits set out in (1) and (2) above.

Transitional Provisions

- 10-193 (4)** **R** **A firm must ensure that, after 31 December 1995, all *non-trading book exposures* entered into before and outstanding at 5 February 1993 which exceed the limits laid down in (1), (2) and (3) above do not exceed their respective values at 5 February 1993 and may be continued until the contractual maturity where the *firm* is legally bound.**
- 10-193 (5)** **R** **The excess over 25% of *own funds* of any *exposure* subject to the transitional arrangements in (4) above must be included in “D” under rules 10-194(3) and 10-195 below.**
- G** **In applying rules 10-194(3) and 10-195, a *firm’s* excess *exposures* under (5) above should be ranked by counterparty weighting, with any *LER* applied to the liquidity adjustment for that *exposure* multiplied by 200% under rule 10-194(3)(d) or by the appropriate percentage in Table 10-194(3) under rule 10-194(3)(e).**
- 10-194** Calculation of LER
- Method
- 10-194 (1)** **R** **A firm must apply the following procedures for each *large exposure* which exceeds 25% of *own funds* and must then sum the resultant *LERs* to arrive at its total *LER*.**
- Calculation
- 10-194 (2)** **R** **For each third party or *group of connected third parties*, a firm must calculate:**
- (a) the total *non-trading book exposure* (R);**
- (b) the total *trading book exposure* (S); and**
- (c) the sum of the total *non-trading book* and *trading book exposures* (T).**
- 10-194 (3)** **R** **Where the value of “R” is less than 25% of the value of *own funds*, the value of “T” may exceed 25% of the value of *financial resources*, subject to an *LER* calculated in accordance with (a) to (e) below:**
- (a) calculate the excess of “T” over 25% of the value of *financial resources*, known as “D”;**

- (b) rank the *trading book exposures* in “T” on the basis of the specific risk weighting in the case of positions, discounted by the appropriate percentage in accordance with table 27R of appendix 7 in respect of underwriting positions, and the composite *CRR* percentage in the case of counterparty *exposures*, in descending order;
- (c) sum the *trading book exposures* in “T”, starting with the *exposure* attracting the highest specific risk weighting or composite *CRR* percentage, until the sum equals the excess “D”;
- (d) if an excess “D” has persisted for 10 *business days* or less, irrespective of the age of the constituent *exposures*, the *LER* must be 200% of the aggregate of specific risk requirements and *CRR* applicable to those *exposures* forming the excess “D”, in accordance with (b) and (c) above; and
- (e) if an excess “D” has persisted for more than 10 *business days*, irrespective of the age of the constituent *exposures*:
 - (i) allocate the constituent *exposures* forming the excess “D”, in ascending order of specific risk weighting or composite *CRR* percentage, to the appropriate row in the table below, so that the positions with the highest specific risk or composite *CRR* percentage receive the highest percentage charge; and
 - (ii) calculate the *LER* as the product of the specific risk requirement or *CRR* for the *exposure* multiplied by the appropriate percentage.

R TABLE 10-194(3) [see Guidance below]

Excess “D” as a percentage of financial resources	Percentage
up to 40	200
40 to 60	300
60 to 80	400
80 to 100	500
100 to 250	600
> 250	900

- G The composite *CRR* percentage should be calculated with reference to the actual percentage used to determine *CRR* in accordance with *CRR* rules, i.e. 8% multiplied by the appropriate counterparty weight in most cases.

- 10-195** Limits for an excess “D”
- 10-195 (1)** R Where an excess “D” has persisted for 10 *business days* or less, the *trading book exposure* must not exceed 500% of *financial resources*.
- 10-195 (2)** R The aggregate of a *firm’s* excess “Ds”, each of which have persisted for more than 10 *business days*, must not exceed 600% of *financial resources*.
- Exposures monitoring for firms exempt from consolidated supervision
- 10-196** R A *firm* which is exempt from consolidated supervision in accordance with rule 14.1.4R must either:
- (a) have in place an *ACMP* which enables the *firm* to monitor its *exposures* on a group wide basis; or
 - (b) report to the *FSA* all group *large exposures* at the end of each quarter.

Consolidated Supervision

Under the Financial Conglomerates and Other Financial Groups Instrument 2004, the rules in Chapter 14 shall (with respect to a particular firm, group or financial conglomerate) apply from the first day of its financial year beginning in 2005 in place of rules 10-20(1) to 10-204.

- 10-200** [deleted]
- Scope
- 10-200 (1)** R [deleted]
- Consolidating Supervisor
- 10-200 (2)** R [deleted]
- G [deleted]
- Constituents of a Group
- 10-200 (3)** R [deleted]

- 10-200 (4) G [deleted]
- Exemptions
- 10-200 (5) R **A *firm* may, having first notified the FSA in writing, exclude from its group, the following:**
- (a) **any *subsidiary* or *participation*, the total assets of which are less than the lower of euro 10 million or 1% of the total assets of the *firm*; and**
 - (b) **any *subsidiary*, *participation* or *EEA parent* the inclusion of which within the group would lead to a misleading or inappropriate consolidation,**
- provided that in aggregate the total assets of such *subsidiaries* and *participations* would still satisfy (a) above.**

Additional Information

- 10-200 (6) G The FSA may require a firm to provide information about the position in the group of any undertaking excluded from the consolidated group in 10-200(5)R.
- 10-200 (7) R **Where a *firm's parent* is a *mixed activity holding company*, the *firm* must provide a copy of the holding company's *audited annual financial statement* and details of its group structure.**

GROUP FINANCIAL RESOURCES

- 10-201 R **A *firm* must calculate the externally generated *financial resources* of its group as the sum of:**
- (a) **the *financial resources* of the most senior undertaking in the group calculated in accordance with Table 10-62(2)A, except *material holdings* in *credit institutions* and *financial institutions* in the group and deficiencies in *subsidiaries* need not be deducted; and**
 - (b) **for each *subsidiary* or *participation*, the group's *share* of the *financial resources* of the *subsidiary* or *participation*, calculated in accordance with Table 10-62(2)A, which was not provided by undertakings within the group subject to consolidated supervision, provided that:**
 - (i) **these *financial resources* are freely transferable and suitable for the purposes of covering the group's *financial resources requirement*; or**

- (ii) if not, they are limited to the value of the *subsidiary's* or *participation's financial resources requirement* from which they originate.

10-202 GROUP FINANCIAL RESOURCES REQUIREMENT

- 10-202 (1) R** A *firm* must calculate the group *financial resources requirement* as the aggregate of the *financial resources requirements* of the *firm* and any constituents of its group determined in accordance with rules 10-200(3), (4) and (5) and the consolidated *LER*.
- 10-202 (2) R** The *financial resources requirement* of any *subsidiary* or *participation* of the *firm* or its *parent* shall be the higher of:
- (a) the *subsidiary* or *participation's* local regulatory capital requirement, excluding any *large exposure* capital charges; and
 - (b) any requirement imposed on the *firm's* or *parent's subsidiary* or *participation* determined in accordance with rule 10-202(4).
- 10-202 (3) R** The *financial resources requirement* of the most senior undertaking within the group shall be its local regulatory capital requirement, if any, excluding any *large exposure* capital charges.
- 10-202 (4) R** Where a *firm* has a *parent, subsidiary* or *participation* which is not subject to local regulatory capital requirements, it must include in the group *financial resources requirement* any alternative requirement calculated on the business of that *parent, subsidiary* or *participation*, or the group's *investment* in that *subsidiary* or *participation*, which is imposed on it by a *requirement*.
- G The *FSA* envisages imposing such a *requirement* where, for example, a *firm* has an unregulated *subsidiary* which deals in *OTC derivatives*, and the *investment* in that *subsidiary* would not constitute an accurate measurement of the risk to the group.
- 10-202 (5) G Where a *firm* has a *parent, subsidiary* or *participation* which is subject to local regulatory capital requirements, it may seek a modification or waiver permitting it to adopt an alternative methodology of determining the group's *financial resources requirement*.
- G The *FSA* only envisages a modification or waiver under this rule in exceptional circumstances, for example to permit line-by-line consolidation of a group to determine its *financial resources requirement*.

INTRA-GROUP OFFSETS AND NETTING

- 10-203 R** If a group's *financial resources*, calculated in accordance with rule 10-201, do not exceed the group's *financial resources requirement*, calculated in accordance with rule 10-202, the *firm* may take into account:
- (a) the benefits of netting intra-group counterparty *exposures*;

- (b) offsetting positions, for the purposes of rules in appendices 4,5, and 8, held by different group companies; and
- (c) the group's *share* of capital surpluses in *subsidiaries* not subject to local regulatory capital requirements,

provided that:

- (d) the *firm* can ensure that the group has sufficient *financial resources* to cover its *financial resources requirements* at all times between *consolidated reporting statements*;
- (e) there is satisfactory allocation of capital within the group;
- (f) the regulatory, legal and contractual framework is sufficient to guarantee mutual financial support within the group;
- (g) such intra-group benefits are only recognised where no regulations exist in the country of incorporation of the entity which might significantly affect the transfer of funds within the group.

EXEMPTION FROM CONSOLIDATED SUPERVISION

10-204 R A *firm* need not apply rules 10-200 to 10-203 to the *firm's* group if:

- (a) there are no *credit institutions* in the group;
- (b) all *investment firms* within the group:
 - (i) calculate *financial resources* in accordance with Table 10-62(2)B;
 - (ii) deduct *material holdings* in *credit institutions* and *financial institutions* in accordance with rule 10-61(7); and
 - (iii) comply with rule 10-70, with local regulatory capital provisions implementing the Capital Adequacy Directive, or rules with equivalent effect;
- (c) the *firm* complies with rule 10-196;
- (d) the *firm's* group has in place systems to monitor and control the sources of capital and funding of all other *investment firms* and *financial institutions* in the group; and
- (e) the *firm* first notifies the *FSA* in writing that it intends to rely upon this rule.

- 10-300** ACMPs
- 10-300 (1)** R **A *firm* may only use an *ACMP* for the purposes of rules 10-170 to 10-176 if:**
- (a) the policies and procedures making up the proposed *ACMP* are at all times adequate and appropriate to the *firm* and its business; and**
 - (b) the *firm* gives to the *FSA* at least three months' notice in writing of its intention to use an *ACMP* for the purposes of these rules.**
- 10-300 (2)** R **The notice referred to in (1)(b) above must include all relevant details of the policies and procedures making up the proposed *ACMP*.**
- 10-300 (3)** R **The notice referred to in (1)(b) is not required if the *firm* was permitted under the relevant requirements of a predecessor regulator, as they were in force immediately prior to the specified day, to use the proposed *ACMP* for the purposes of those requirements.**
- 10-300(4) E
- (a) A *firm*'s policies and procedures should take full account of the principles described in **Appendix 56**.
 - (b) Compliance with 10-300(4)(a) may be relied on as tending to establish compliance with 10-300(1)(a).
 - (c) Contravention of 10-300(4)(a) may be relied on as tending to establish contravention of 10-300(1)(a).
- G On receipt of notice under (1)(b) the *FSA* is likely to review the policies and procedures proposed by the *firm* and the degree to which they take full and appropriate account of the matters described in **Appendix 56**. The *FSA*'s review will take account of the context in which the policies and procedures are to operate and the relevant circumstances of the *firm*. The *FSA* will indicate to the *firm* its views on the adequacy and appropriateness of the proposals in the light of its review and may make recommendations of improvements.
- G The *FSA* may make a further review of the policies and procedures making up an *ACMP* at any time after their implementation for the purposes of these rules as part of its supervision of the *firm*. Any review after implementation will broadly follow the lines described above.

APPENDIX 1 – GLOSSARY OF TERMS FOR IPRU(INV) 10

If a defined term does not appear in the IPRU(INV) 10 glossary below, the definition appearing in the main Handbook *Glossary* applies.

- acceptable collateral means any of the following items of collateral provided to a *firm* by a *counterparty*:
- (a) cash;
 - (b) gold and silver bullion and coinage;
 - (c) certificates of deposit issued by and lodged with the *firm*;
 - (d) securities issued by *Zone A* central governments and *Zone A* central banks; and
 - (e) *securities* issued by the *European Communities*,
- to which the following conditions apply:
- (i) the *firm* must have an unconditional right to apply or realise the *acceptable collateral* for the purpose of repaying the counterparty's obligations to the *firm*; and
 - (ii) *securities* must be *marked to market* daily using the valuation principles in rule 10-41(9);
- ACMP means, subject to rule 10-300, a credit management policy and procedures according with the principles discussed in **Appendix 56**;
- Act means the Financial Services and Markets Act 2000;
- adequate collateral means any of the following items of collateral provided to a *firm* by a counterparty:
- (a) cash;
 - (b) standby letters of credit and unconditional, irrevocable first on demand guarantees to the extent of their face value, issued by a *Zone A credit institution* which is not the counterparty nor an *associate* of the counterparty, and which is not an *affiliated company*, *associate* or a *controller* of the *firm*;
 - (c) standby letters of credit and unconditional, irrevocable first on demand guarantees to the extent of their face value, issued by a bank which is not a *Zone A credit institution* (not being the counterparty nor an *associate* of the counterparty) which has been accepted under the *firm's ACMP* and which is not an *affiliated company*, *associate* or a *controller* of the *firm*;

- (d) *certificates of deposit*;
- (e) gold and silver bullion and coinage;
- (f) *securities*;
- (g) *physical commodities*; and
- (h) the performance guarantees issued in support of the securities lending and borrowing programmes of Euroclear and Clearstream, in respect only of exposure arising from participation in such programmes,

to which the following conditions apply -

- (i) the *firm* must have an unconditional right to apply or realise the collateral for the purpose of repaying the counterparty's obligations to the *firm*; and
- (ii) *securities* must -
 - (aa) be *marked to market* daily using the valuation principles in rule 10-41(9); and
 - (bb) not be issued by the counterparty nor by an *associate* of the counterparty;

<i>affiliated company</i>	in relation to a <i>firm</i> , means any <i>body corporate</i> controlled by the <i>firm</i> , any parent company of the <i>firm</i> , and any <i>body corporate</i> controlled by a parent company of the <i>firm</i> ;
<i>annual accounting reference date</i>	means the date as at which the <i>audited annual financial statements</i> are prepared as initially notified by the <i>firm</i> to the FSA or as subsequently notified under rule 10-31 and which may not be more than 55 weeks since the previous <i>annual accounting reference date</i> or, if applicable, the date on which the <i>firm</i> commenced trading;
<i>appointed representative</i>	means (in accordance with section 39 of the <i>Act</i>) a person (other than an <i>authorised person</i>) who: <ul style="list-style-type: none"> (a) is a party to a contract with an <i>authorised person</i> (his principal) which: <ul style="list-style-type: none"> (i) permits or requires him to carry on business of a description prescribed in the Financial Services and Markets Act 2000 (Appointed Representatives) Regulations 2001 (SI 2001/1217); and (ii) complies with the requirements prescribed in those Regulations; and (b) is someone for whose activities in carrying on the whole or part of that business his principal has accepted responsibility in writing;

- approved bank* (in relation to a bank account opened by a *firm*) means:
- (a) if the account is opened at a branch in the *United Kingdom*:
 - (i) the Bank of England; or
 - (ii) the central bank of a member state of the *OECD*; or
 - (iii) a *bank*; or
 - (iv) a *building Society* which offers, unrestrictedly, banking services; or
 - (v) a bank which is supervised by the central bank or other banking regulator of a member state of the *OECD*; or
 - (b) if the account is opened elsewhere:
 - (i) a bank in (a); or
 - (ii) a *credit institution* established in an *EEA State* other than the *United Kingdom* and duly authorised by the relevant *Home State regulator*; or
 - (iii) a bank which is regulated in the Isle of Man or the Channel Islands; or
 - (c) a bank supervised by the South African Reserve Bank; or
 - (d) any other bank that:
 - (i) is subject to regulation by a national banking regulator;
 - (ii) is required to provide audited accounts;
 - (iii) has minimum net assets of £5 million (or its equivalent in any other currency at the relevant time) and has a surplus revenue over expenditure for the last two financial years; and
 - (iv) has an annual audit report which is not materially qualified;

approved person means a *person* in relation to whom the *FSA* has given its approval under section 59 of the *Act* (Approval for particular arrangements) for the performance of a *controlled function*;

arranger means a *firm* -

- (a) whose sole *investment business* consists of activities within the following articles of the Regulated Activities Order -
 - (i) articles 14 (dealing in investments as principal) or 21 (dealing in investments as agent) if -

- (aa) the *firm* is a *venture capital firm*; or
 - (bb) the activity is own account business which would be excluded from being *investment business* by the provisions of article 16 of the Regulated Activities Order but for the fact that the firm is an *authorised person*; or
 - (ii) article 25(1) (arranging deals in investments);
 - (iii) article 37 (managing investments); and
 - (iv) article 53 (advising on investments);
 - (b) whose *permission* is subject to a *limitation* or *requirement* preventing it from holding money or property belonging to other persons nor has a mandate over a *customer's* bank account;
- associate* in relation to a person ("A"), means -
- (a) an undertaking in the same *group* as A;
 - (b) an *appointed representative* of A or of any undertaking in the same *group* as A; and
 - (c) any other person whose business or domestic relationship with A or its *associate* might reasonably be expected to give rise to a community of interest between them which may involve a conflict of interest in dealings with third parties;
- associated business* means business which is carried on in connection with *investment business*;
- audited annual financial statements* means statements drawn up in accordance with Schedule 4 to the Companies Act 1985 or, where applicable, *international accounting standards* as at the *firm's annual accounting reference date* together with an *auditor's report* thereon;
- auditor's report* means a report drawn up in the format specified in the *Supervision manual* which a *firm* must submit to the FSA in conjunction with the *firm's audited annual financial statements*;
- authorised person* means (in accordance section 31 of the *Act* (Authorised persons)), one of the following:
- (a) a *person* who has a *Part IV permission* to carry on one or more *regulated activities*;
 - (b) an *incoming EEA firm*;
 - (c) an *incoming Treaty firm*;
 - (d) a *UCITS qualifier*;

	(e) an <i>ICVC</i> ;
	(f) the <i>Society of Lloyd's</i> ;
<i>base currency</i>	means the currency currently used by a firm to calculate its financial resource requirements;
<i>body corporate</i>	means (in accordance with section 417(1) (Definitions)) any body corporate, including a body corporate constituted under the law of a country or territory outside the United Kingdom, of the <i>Act</i> ;
<i>bonus</i>	means that part of the remuneration paid by a <i>firm</i> to its <i>employees</i> (including <i>directors</i>) which is - <ul style="list-style-type: none"> (a) not a <i>profit share</i>; and (b) awarded by management entirely on a discretionary basis, to the extent that it does not exceed the profit for the financial year of the <i>firm</i> before accounting for such bonus;
<i>business day</i>	means any day, except Saturday, Sunday, bank holidays and public holidays (not being bank holidays);
<i>buy and sale back agreement</i>	see <i>reverse repurchase agreement</i> ;
<i>call options</i>	means an <i>option</i> to buy an <i>investment</i> , other instrument, foreign currency or <i>physical commodity</i> at a given price on or before a given date;
<i>category A firm</i>	means a <i>firm</i> which has <i>permission</i> to provide any <i>core investment service</i> and which is not a <i>category B, C or D firm</i> ;
<i>category B firm</i>	means a <i>firm</i> which - <ul style="list-style-type: none"> (a) has <i>permission</i> to provide any of the following <i>core investment services</i> - <ul style="list-style-type: none"> (i) receiving and transmitting orders; (ii) executing orders; (iii) managing <i>investments</i> on a discretionary basis; and (iv) dealing as principal, but only holding positions as a result of its failure to match investors' orders precisely; and <ul style="list-style-type: none"> (aa) such positions are incidental and provisional in nature and strictly limited to the time required to carry out the transaction in question; and (bb) the total market value of all such positions does not exceed 15% of the <i>firm's initial capital</i>; and (b) holds <i>client money</i> or <i>clients' assets</i>; or

	(c) is a <i>custodian</i> ;
<i>category C firm</i>	means a <i>firm</i> which -
	(a) has <i>permission</i> to provide any of the following core investment services -
	(i) receiving and transmitting;
	(ii) managing <i>investments</i> on a discretionary basis; and
	(iii) executing orders on an agency basis; and
	(b) whose <i>permission</i> is subject to a <i>limitation</i> or <i>requirement</i> preventing it from holding <i>client money</i> or <i>clients' assets</i> ;
<i>category D firm</i>	means a <i>firm</i> , the only <i>core investment service</i> for which it has <i>permission</i> is receiving and transmitting on behalf of investors orders in relation to one or more of the instruments listed in Section B of the Annex to the <i>ISD</i> , and whose <i>permission</i> is subject to a <i>limitation</i> or <i>requirement</i> preventing it from holding <i>client money</i> or <i>clients' assets</i> and for that reason may not at any time place itself in debit with its <i>clients</i> , which benefits from the freedom of establishment or to provide services under Articles 14 or 15 of the <i>ISD</i> ;
<i>certificate of deposit</i>	means a negotiable or non-negotiable certificate issued by a bank;
<i>CFDs</i>	means <i>contract for differences</i> ;
<i>clearing firm</i>	means a firm which accepts primary responsibility (including legal liability) for the settlement of transactions for counterparties;
<i>client</i>	means any <i>person</i> with or for whom a <i>firm</i> conducts or intends to conduct <i>designated investment business</i> or any other <i>regulated activity</i> ; and:
	(a) every client is a <i>customer</i> or a <i>market counterparty</i> ;
	(b) "client" includes:
	(i) a potential client;
	(ii) a client of an <i>appointed representative</i> of a <i>firm</i> with or for whom the <i>appointed representative</i> acts or intends to act in the course of business for which the <i>firm</i> has accepted responsibility under section 39 of the <i>Act</i> (Exemption of appointed representatives);
	(iii) a <i>collective investment scheme</i> even if it does not have separate legal personality;
	(iv) if a <i>person</i> ("C1"), with or for whom the <i>firm</i> is conducting or intends to conduct <i>designated</i>

investment business, is acting as agent for another *person* (“C2”), either C1 or C2 in accordance with COB 4.1.5R (Agent as client);

- (c) "client" does not include:
 - (i) a trust beneficiary;
 - (ii) a *corporate finance contact*;
 - (iii) a *venture capital contact*;

<i>client money</i>	subject to the <i>client money rules</i> , means <i>money</i> of any currency which, in the course of carrying on <i>designated investment business</i> , a <i>firm</i> holds in respect of any <i>investment agreement</i> entered into, or to be entered into, with or for a <i>client</i> , or which a <i>firm</i> treats as <i>client money</i> in accordance with the <i>client money rules</i> ;
<i>client money rules</i>	means CASS 4.1 to 4.3;
<i>collective investment scheme</i>	means a collective investment scheme, as defined in section 235 of the <i>Act</i> (Collective Investment Schemes), which is in summary: <ul style="list-style-type: none">(a) any arrangements with respect to property of any description, including money, the purpose or effect of which is to enable <i>persons</i> taking part in the arrangements (whether by becoming owners of the property or any part of it or otherwise) to participate in or receive profits or income arising from the acquisition, holding, management or disposal of the property or sums paid out of such profits or income; and(b) which are not excluded by the Financial Services and Markets Act (Collective Investment Schemes) Order 2001 (SI 2001/1062);
<i>commissions shared</i>	means that part of the remuneration paid by a <i>firm</i> which is determined on the basis of the number, size or profitability of individual deals carried out;
<i>commodity</i>	means any physical or energy product (except gold) which is, or can be traded on a secondary market. (NB: the definition of a commodity used for the purposes of Chapter 10 of IPRU(INV) deliberately differs from that in the main Handbook Glossary);
<i>company</i>	means any <i>body corporate</i> ;
<i>connected company</i>	(and “ <i>connected credit institution</i> ”) mean, in relation to a <i>firm</i> which - <ul style="list-style-type: none">(a) is a <i>body corporate</i>, a <i>body corporate</i> or <i>credit institution</i> satisfying any of the following conditions -<ul style="list-style-type: none">(i) the same person is the <i>controller</i> of each <i>body</i>

- corporate or credit institution*;
- (ii) if a group of two or more persons are *controllers* of each *body corporate* or *credit institution* and the group either consists of the same persons or could be regarded as consisting of the same persons by treating a member of either group as replaced by -
 - (aa) that member's *close relative*;
 - (bb) a person with whom that member is in partnership; or
 - (cc) a *body corporate* of which the member is an officer; or
- (iii) both *body corporates* are members of the same group; or
- (b) is not a *body corporate*, a *body corporate* or *credit institution* which is controlled -
 - (i) by the *firm*;
 - (ii) by a *partner* in the *firm*;
 - (iii) by a *close relative* of a *partner* in the *firm* or, if the *firm* is a *sole trader*, by a *close relative* of the *sole trader*; or
 - (iv) collectively by any of the *partners* in the *firm* or their *close relatives*;

connected credit institution

see "*connected company*";

consolidated reporting statement

means a statement drawn up in accordance with the requirements for consolidated reporting in the *Supervision manual* and prepared as at the date(s) required by the *Supervision manual*;

contingency

means a future event the outcome of which is uncertain;

contingent liability

means a liability dependent upon the occurrence or non-occurrence of one or more uncertain future events;

contract for differences

means as specified in article 85 of the Regulated Activities Order (Contracts for differences etc), rights under:

- (a) a contract for differences; or
- (b) any other contract the purpose or pretended purpose of which is to secure a profit or avoid a loss by reference to fluctuations in:
 - (i) the value or price of property of any description; or
 - (ii) an index or other factor designated for that purpose

in the contract;

controller

means -

(a) in relation to a *body corporate* -

- (i) a person, who alone or with any *associate* or *associates*, has a direct or indirect holding in the *body corporate* which represents 10% or more of the capital or of the voting rights; and
- (ii) any person who has a direct or indirect holding in the *body corporate* which makes it possible to exercise a significant influence over the management of the *body corporate*; and

(b) in relation to an unincorporated association -

- (i) any person in accordance with whose directions or instructions the officers of the association are accustomed to act (but disregarding advice given in a professional capacity);
- (ii) any person who is entitled to exercise, or control the exercise of, 10% or more of the voting power at any general meeting of the association; and
- (iii) any person who has a direct or indirect holding in the association which makes it possible to exercise a significant influence over the management of the association;

and “*control*” shall be construed accordingly;

convertible

means a *security* which gives the investor the right to convert the *security* into equity at an agreed price or on an agreed basis;

core investment service

means a service listed in Section A of the Annex to the *ISD*, the text of which is set out in Schedule 2 of the Regulated Activities Order;

corporate finance advisory firm

means a *firm* which is an *arranger* and whose *permission* includes a *requirement* that it must not conduct *investment business* other than *corporate finance business*;

corporate finance business

means:

- (a) *designated investment business* carried on by a *firm* with or for:
 - (i) any *issuer*, holder or owner of *designated investments*, if that business relates to the *offer*, issue, underwriting, repurchase, exchange or redemption of, or the variation of the terms of, those

- investments*, or any related matter;
- (ii) any *market counterparty* or *intermediate customer*, or other *body corporate*, *partnership* or supranational organisation, if that business relates to the manner in which, or the terms on which, or the *persons* by whom, any business, activities or undertakings relating to it, or any *associate*, are to be financed, structured, managed, controlled, regulated or reported upon;
 - (iii) any *person* in connection with:
 - (A) a proposed or actual *takeover or related operation* by or on behalf of that *person*, or involving *investments* issued by that *person* (being a *body corporate*), its *holding company*, *subsidiary* or *associate*; or
 - (B) a merger, de-merger, reorganisation or reconstruction involving any *investments* issued by that *person* (being a *body corporate*), its *holding company*, *subsidiary* or *associate*;
 - (iv) any shareholder or prospective shareholder of a *body corporate* established or to be established for the purpose of effecting a *takeover or related operation*, where that business is in connection with that *takeover or related operation*;
 - (v) any *person* who, acting as a *principal* for his own account:
 - (A) is involved in negotiations or decisions relating to the commercial, financial or strategic intentions or requirements of a business or prospective business; or
 - (B) (provided he is acting otherwise than solely in his capacity as an investor) assists the interests of another *person* with or for whom the *firm*, or another *authorised person* or *overseas person*, is undertaking business as specified in (a)(i),(ii),(iii) or (iv), by himself undertaking all or part of any transactions involved in such business;
 - (vi) any *person* undertaking business with or for a *person* as specified in (a)(i), (ii), (iii), (iv) or (v) in respect of activities described in those sub-paragraphs;
- (b) *designated investment business* carried on by a *firm* as a *principal* for its own account where such business:

- (i) is in the course of, or arises out of, activities undertaken in accordance with (a); and
 - (ii) does not involve transactions with or for, or *advice on investments* to, any other *person* who is a *private customer* in respect of such business;
- (c) *designated investment business* carried on by a *firm* as *principal* for its own account if such business:
- (i) is in the course of, or arises out of:
 - (A) the *offer*, issue, underwriting, repurchase, exchange or redemption of, or the variation of the terms of, *shares*, share warrants, *debentures* or debenture warrants issued by the *firm*, or any related matter; or
 - (B) a proposed or actual *takeover or related operation* by or on behalf of the *firm*, or involving *shares*, share warrants, *debentures* or debenture warrants issued by the *firm*; or
 - (C) a merger, de-merger, reorganisation or reconstruction involving any *shares*, share warrants, *debentures* or debenture warrants issued by the *firm*; and
 - (ii) does not involve giving *advice on investments* to any *person* who is a *private customer*;

in this definition, “share warrants” and “debenture warrants” mean any *warrants* which relate to *shares* in the *firm* concerned or, as the case may be, *debentures* issued by the *firm*;

<i>CRR</i>	means the counterparty risk requirement, as calculated under rules 10-170 to 10-175;
<i>custodian</i>	means a <i>firm</i> which has <i>permission</i> to safeguard and administer assets belonging to another, in accordance with article 40 of the Regulated Activities Order;
<i>customer</i>	means a <i>client</i> who is not a <i>market counterparty</i> ;
<i>debenture</i>	means the investment specified in article 77 of the Regulated Activities Order (Instruments creating or acknowledging

indebtedness), which is in summary: any of the following which are not *government and public securities*:

- (a) debentures;
- (b) debenture stock;
- (c) loan stock;
- (d) bonds;
- (e) certificates of deposit;
- (f) any other instruments creating or acknowledging indebtedness;

<i>derivatives</i>	means <i>options, futures and contracts for differences</i> ;
<i>designated investment exchange</i>	means any investment exchange which is defined as such in the central Handbook Glossary;
<i>director</i>	in relation to a <i>body corporate</i> includes - <ul style="list-style-type: none">(a) any person occupying the position of <i>director</i> by whatever name called;(b) any person in accordance with whose directions or instructions (not being advice given in a professional capacity) the <i>directors</i> are accustomed to act; or(c) in the case of an <i>overseas firm</i>, any person who occupies a position analogous to that of a <i>director</i> of a company registered under the Companies Act 1985;
<i>documents of title</i>	means documents of title and documents evidencing title to <i>investments</i> and commodities;
<i>EEA</i>	means the area established by the agreement on the European Economic Area signed at Oporto on 2 May 1992 and which consists of the <i>EEA States</i> ;
<i>EEA State</i>	see definition of <i>EEA State</i> in the <i>Glossary</i> ;
<i>eligible collective investment scheme</i>	means - <ul style="list-style-type: none">(a) a <i>regulated collective investment scheme</i>; or(b) a scheme, authorised in another state within the <i>EEA</i>, which complies with the requirements of the European Community directive on Undertakings for Collective Investment in

	Transferable Securities (UCITS - 85/611/EEC);
<i>employee</i>	in relation to any person, means an individual - <ul style="list-style-type: none"> (a) who is employed by that person under a contract of service, a contract for services, or any other contract under which the individual will provide services to the person; (b) who is a <i>director</i> of the person where the person is a <i>body corporate</i>; (c) who is a <i>partner</i> of the person where the person is a partnership; (d) who, where the person is an unincorporated association, is a member of its governing body, the secretary or treasurer; or (e) whose services are, under an arrangement between the person and a third party, placed at the disposal and under the control of the person;
<i>equity</i>	means <i>share</i> ;
<i>European business</i>	means business carried on in or into a <i>member state</i> in accordance with <i>ISD</i> or <i>BCD</i> ;
<i>European Communities</i>	means Euratom (European Atomic Energy Community), the European Coal and Steel Community and the European Economic Community;
<i>exceptional items</i>	means those items which derive from events or transactions within the ordinary activities of the business of a <i>firm</i> and which are both material and not expected to recur frequently or regularly;
<i>exchange</i>	means a <i>recognised investment exchange</i> , or <i>designated investment exchange</i> ;
<i>exposure</i>	means for the purposes of rules 10-190 to 10-195 and 10-32(3) to (7), the amount at risk to a <i>firm</i> determined in accordance with rule 10-191;
<i>financial holding company</i>	means a <i>financial institution</i> the <i>subsidiary</i> undertakings of which are either exclusively or mainly <i>credit institutions</i> , <i>investment firms</i> and <i>financial institutions</i> , one of which at least is a <i>credit institution</i> or an <i>investment firm</i> ;
<i>financial institution</i>	means an undertaking other than a <i>credit institution</i> , the principal activity of which is to acquire holdings or to carry on a <i>listed activity</i> ;
<i>financial instrument</i>	means any of the following - <ul style="list-style-type: none"> (a) a transferable <i>security</i>;

	<ul style="list-style-type: none"> (b) a unit in a <i>collective investment scheme</i>; l a money market instrument; (d) a financial <i>future</i> contract, including an equivalent cash settled instrument; (e) an <i>FRA</i>; (f) an interest rate, currency or equity <i>swap</i>; (g) an <i>option</i> to acquire or dispose of any of the above instruments, including an equivalent cash-settled instrument;
<i>financial reporting statement</i>	means the periodic financial and other reporting statements required to be provided to the <i>FSA</i> under the provisions of Chapter 16 of the <i>Supervision manual</i> ;
<i>financial resources</i>	means the financial resources of the <i>firm</i> calculated in accordance with rule 10-62(2)A or, if permitted, in accordance with rule 10-62(2)B;
<i>financial resources requirement</i>	means the financial resources requirement of the <i>firm</i> calculated in accordance with rule 10-70;
<i>firm</i>	means an <i>authorised person</i> ;
<i>forward</i>	A contract to buy or sell where the date for settlement has been agreed as a particular date in the future;
<i>FRA</i>	means <i>forward</i> rate agreement, i.e. an agreement in which two parties agree on the payment by one party to another of an amount of interest based on an agreed interest rate for a specified period from a specified settlement date applied to an agreed principal amount; no commitment is made by either party to lend or borrow the principal amount; their exposure is only the interest difference between the agreed and actual rates at settlement;
<i>free delivery</i>	means – <ul style="list-style-type: none"> (a) the delivery of <i>securities</i> or <i>physical commodities</i> which takes place before the seller receives payment; or (b) payment made in settlement of a credit balance arising from a sale on behalf of, or a purchase from a counterparty in respect of which the <i>securities</i> are undelivered;
<i>FSA</i>	means The Financial Services Authority;
<i>FSA authorised business</i>	means any activity within the <i>permissions</i> granted to a <i>firm</i> under the <i>Act</i> ;

- future* means the investment, specified in article 84 of the Regulated Activities Order (Futures), which is, in summary: rights under a contract for the sale or delivery of a commodity or property of any other description under which delivery is to be made at a future date and at a price agreed on when the contract is made;
- government and public securities* means the *investment*, specified in article 78 of the *Regulated Activities Order* (Government and public securities), which is in summary: a loan stock, bond or other instrument creating or acknowledging indebtedness, issued by or on behalf of any of the following:
- (a) the government of the United Kingdom; or
 - (b) the Scottish Administration; or
 - (c) the Executive Committee of the Northern Ireland Assembly; or
 - (d) the National Assembly of Wales; or
 - (e) the government of any country or territory outside the United Kingdom; or
 - (f) a local authority in the United Kingdom or elsewhere; or
 - (g) a body the members of which comprise:
 - (i) states including the United Kingdom or another *EEA State*; or
 - (ii) bodies whose members comprise states including the United Kingdom or another *EEA State*;
 but excluding:
 - (A) the instruments specified in article 77(2)(a) to (d) of the *Regulated Activities Order*;
 - (B) any instrument creating or acknowledging indebtedness in respect of:
 - (I) money received by the Director of Savings as *deposits* or otherwise in connection with the business of the National Savings Bank; or
 - (II) money raised under the National Loans Act 1968 under the auspices of the Director of Savings or treated as so raised under section 11(3) of

the National Debt Act 1972;

group

means (in accordance with section 421 of the Act (Group)), in relation to a person ("A"), A and any person who is:

- (a) a parent undertaking of A;
- (b) a subsidiary undertaking of A;
- (c) a subsidiary undertaking of a parent undertaking of A;
- (d) a parent undertaking of a subsidiary undertaking of A;
- (e) an undertaking in which A or an undertaking in (a) to (d) has a participating interest;
- (f) if A or an undertaking in (a) or (d) is a *building society*, an associated undertaking of that *building society*;
- (g) if A or an undertaking in (a) or (d) is an *incorporated friendly society*, a *body corporate* of which that *friendly society* has joint control (as defined in section 13(9)(c) or (cc) of the Friendly Societies Act 1992);

in this definition:

- (i) "participating interest" has the same meaning as in Part VII of the Companies Act 1985 or Part VIII of the Companies (Northern Ireland) Order 1986; but also includes an interest held by an individual which would be a participating interest for the purposes of those provisions if he were an undertaking;
- (ii) "associated undertaking" has the meaning given in section 119(1) of the Building Societies Act 1986;

group of connected third parties

means a close relationship where -

- (a) two or more entities in a close relationship constitute a single risk because one of them, directly or indirectly, has control over the other or others as defined in section 258 of the Companies Act 1985, or a similar relationship between any natural or legal person and an undertaking; or
- (b) two or more entities between whom there is no relationship of control as defined in (a) but who are to be regarded as constituting a single risk, are so interconnected that the financial soundness of one would be affected by the financial soundness of the other or others;

illiquid asset

means any one of the following -

- (a) a tangible fixed asset except to the extent that land and

	buildings are used as security for loans;
	(b) physical stocks except for positions in <i>physical commodities</i> which are subject to a <i>PRR</i> ;
	(c) an <i>investment</i> in a <i>credit institution</i> or <i>financial institution</i> which may be included in the <i>own funds</i> of that institution, unless it -
	(i) is a <i>material holding</i> and is treated in accordance with rule 10-61(8); or
	(ii) is not a <i>material holding</i> and is included in the <i>firm's trading book</i> and subject to a <i>PRR</i> ;
	(d) an <i>investment</i> in an undertaking other than a <i>credit institution</i> or <i>financial institution</i> unless it is part of the <i>firm's trading book</i> and is subject to a <i>PRR</i> ;
	(e) a non <i>qualifying deposit</i> ; or
	(f) a loan or other amount due except where it is due to be repaid within 90 days;
<i>in the money</i>	means the strike price of a call <i>option</i> or <i>warrant</i> is less than the current market value of the underlying instrument, or vice versa for a put <i>option</i> ;
<i>incoming EEA firm</i>	(in accordance with section 193(1)(a) of the <i>Act</i> (Interpretation of this Part)) means an <i>EEA firm</i> which is exercising, or has exercised, its right to carry on a <i>regulated activity</i> in the <i>United Kingdom</i> in accordance with Schedule 3 to the <i>Act</i> (EEA Passport Rights);
<i>initial capital</i>	means the initial capital of a <i>firm</i> calculated in accordance with Table 10-61(1)A;
<i>inter-professional</i>	for the purposes of <i>repurchase</i> , <i>reverse repurchase</i> , <i>sale and buy back</i> and <i>buy and sale back agreements</i> means an agreement with a counterparty which is one of the following -
	(a) a <i>Zone A credit institution</i> ;
	(b) an <i>investment firm</i> ;
	(c) a <i>recognised third country investment firm</i> ;
	(d) a <i>recognised exchange</i> ;
	(e) a <i>recognised clearing house</i> ;
<i>intermediate broker</i>	in relation to a <i>margined transaction</i> , means any person through whom the <i>firm</i> undertakes that transaction;
<i>intermediate customer</i>	means a <i>client</i> who is not a <i>market counterparty</i> and who is:
	(a) a local authority or public authority;

- (b) a *body corporate* whose *shares* have been *listed* or *admitted to trading* on any *EEA* exchange;
- (c) a *body corporate* whose *shares* have been *listed* or *admitted to trading* on the primary board of any *IOSCO* member country official exchange;
- (d) a *body corporate* (including a *limited liability partnership*) which has (or any of whose *holding companies* or *subsidiaries* has) (or has had at any time during the previous two years) called up share capital or net assets of at least £5 million (or its equivalent in any other currency at the relevant time);
- (e) a *special purpose vehicle*;
- (f) a *partnership* or unincorporated association which has (or has had at any time during the previous two years) net assets of at least £5 million (or its equivalent in any other currency at the relevant time) and calculated in the case of a limited *partnership* without deducting loans owing to any of the *partners*;
- (g) a trustee of a trust (other than an *occupational pension scheme*, *SSAS* or *stakeholder pension scheme*) which has (or has had at any time during the previous two years) assets of at least £10 million (or its equivalent in any other currency at the relevant time) calculated by aggregating the value of the cash and *designated investments* forming part of the trust's assets, but before deducting its liabilities;
- (h) a trustee of an *occupational pension scheme*, *SSAS* or *stakeholder pension scheme* where the trust has (or has had at any time during the previous two years):
 - (i) at least 50 members; and
 - (ii) assets under management of at least £10 million (or its equivalent in any other currency at the relevant time);
- (i) another *firm*, or an *overseas financial services institution*, when, in relation to *designated investment business*, or related *ancillary activities*, conducted with or for that *firm* or institution, that *firm* or institution is an *intermediate customer* in accordance with *COB 4.1.7R* (Classification of another firm or an overseas financial services institution);
- (j) an *unregulated collective investment scheme*;

- (k) a *client* when he is classified as an *intermediate customer* in accordance with COB 4.1.9R (Expert private customer classified as intermediate customer);

but excluding:

- (A) a *regulated collective investment scheme*; and
- (B) a *client* who would otherwise be an *intermediate customer*, when he is classified in accordance with:
 - (I) COB 4.1.12R (Large intermediate customer classified as market counterparty); or
 - (II) COB 4.1.14R (Client classified as private customer);

investment

means (for the purposes of this chapter) any of the following investments specified in Part III of the Regulated Activities Order (Specified investments):

- (a) life policies (subset of article 75);
- (b) shares (article 76);
- (c) debentures (that is, instruments creating or acknowledging indebtedness) (article 77);
- (d) government and public securities (article 78);
- (e) warrants (that is, instruments giving entitlement to investments) (article 79);
- (f) certificates representing certain securities (article 80);
- (g) units (article 81);
- (h) stakeholder pension scheme (article 82);
- (i) options (article 83);
- (j) futures (article 84);
- (k) contracts for differences (article 85);
- (l) rights to or interests in an investment within (a) to (k) (article 89);¹

investment agreement

means any agreement the making or performance of which by either party constitutes an activity which is *investment business*;

investment business

means any of the following regulated activities specified in Part II of the Regulated Activities Order and which is carried on by way

¹ These are the same investments as are included in the definition of "designated investment" used in the main Handbook glossary.

of business:

- (a) dealing in investments as principal (article 14), but disregarding the exclusion in article 15 (Absence of holding out etc);
- (b) dealing in investments as agent (article 21);
- (c) arranging deals in investments for another person (article 25(1)) but only in relation to *investments*;
- (d) making arrangements for deals in investments (article 25(2)) but only in relation to *investments*;
- (e) managing investments (article 37);
- (f) safeguarding and administration of assets (article 40);
- (g) sending dematerialised instructions (article 45(1));
- (h) causing dematerialised instructions to be sent (article 45(2));
- (i) establishing, operating or winding up a collective investment scheme (article 51(1)(a));
- (j) acting as trustee of an authorised unit trust scheme (article 51(1)(a));
- (k) acting as the depositary or sole director of an open-ended investment company (article 48(3));
- (l) advising on investments (article 49); for the purposes of the permission regime, this is sub-divided into:
 - (i) advising on investments (except on pension transfer and pension opt outs);
 - (ii) advice on pension transfers and opt outs;
- (m) agreeing to carry on the activities in (a) to (h) and (l) (article 64);²

investment firm

means any legal or natural person established in the *EEA*, the regular occupation or business of which is the provision of *core investment services* for third parties on a professional basis, in accordance with the *ISD*, excluding -

- (a) any person to whom the *ISD* does not apply by virtue of the provisions of paragraph 2 of article 2 of that directive;
- (b) a *credit institution*, a *local* or a *category D firm*;

² These are the same activities as are included in the definition of "designated investment business" used in the main Handbook glossary.

<i>investment services</i>	means - (a) activities undertaken in the course of carrying on <i>investment business</i> ; and (b) activities undertaken in connection with an <i>ISA</i> where those activities do not constitute <i>investment business</i> ;
<i>ISD</i>	means the Council Directive on investment services in the securities field (Directive No. 93/22/EEC);
<i>large exposure</i>	means - (a) in relation to <i>non-trading book exposures</i> , an <i>exposure</i> or number of <i>exposures</i> to a third party or <i>group of connected third parties</i> which exceed 10% of a <i>firm's own funds</i> ; and (b) in relation to the aggregate of <i>non-trading book</i> and <i>trading book exposures</i> , an <i>exposure</i> or number of <i>exposures</i> to a <i>third party</i> or <i>group of connected third parties</i> which exceed 10% of a <i>firm's financial resources</i> ;
<i>lead regulated firm</i>	means a <i>firm</i> which is subject to the financial regulations of another regulator under a lead regulation arrangement to which the <i>FSA</i> is a party, directly or indirectly;
<i>LER</i>	means the <i>large exposures requirement</i> of a <i>firm</i> as calculated in accordance with rules 10-190 to 10-194;
<i>listed activities</i>	Has the meaning set out in Handbook <i>Glossary</i> for <i>listed activity</i>

<i>local</i>	<p>means a <i>firm</i> which is a member of a <i>futures</i> and <i>options</i> exchange and whose <i>permission</i> includes a <i>requirement</i> that:</p> <p>(a) the <i>firm</i> will not conduct <i>designated investment business</i> other than:</p> <p style="margin-left: 40px;">(i) <i>dealing</i> for its own account on that <i>futures</i> or <i>options</i> exchange;</p> <p style="margin-left: 40px;">(ii) <i>dealing</i> for the accounts of other members of the same <i>futures</i> and <i>options</i> exchange; or</p> <p style="margin-left: 40px;">(iii) making a price to other members of the same <i>futures</i> and <i>options</i> exchange; and</p> <p>(b) the performance of the <i>firm's</i> contracts must be guaranteed by and must be the responsibility of one or more of the clearing members of the same <i>futures</i> and <i>options</i> exchange;</p>
<i>margin requirement</i>	<p>means, in relation to a counterparty, the value of any amounts which the <i>firm</i> or <i>intermediate broker</i> would be required to pay under the rules of an exchange or clearing house to -</p> <p>(a) meet any <i>marked to market</i> losses occurring on contracts undertaken for that counterparty at that time; or</p> <p>(b) as an initial margin fidelity deposit in respect of all the counterparty's open positions at that time,</p> <p>on the assumption that those transactions were the only transactions undertaken on the exchange or clearing house by the <i>firm</i> or <i>intermediate broker</i> at that time;</p>
<i>margined transaction</i>	<p>means a transaction effected by a <i>firm</i> with or for a <i>customer</i> relating to an <i>investment</i> of any description referred to in articles 83, 84 and 85 of the Regulated Activities Order (or any right or any interest in such an <i>investment</i>) under the terms of which the <i>customer</i> will or may be liable to make a deposit in cash or collateral to secure performance of obligations which he may have to perform when the transaction falls to be completed or upon the earlier closing out of his position;</p>
<i>mark to market</i>	<p>means to value an <i>investment</i> at its current market value in accordance with rule 10-41(9);</p>
<i>market counterparty</i>	<p>means a <i>client</i> who is:</p> <p>(a) a properly constituted government (including a quasi-governmental body or a government agency) of any</p>

given country or territory;

- (b) a central bank or other national monetary authority of any country or territory;
- (c) a supranational whose members are either countries or central banks or national monetary authorities;
- (d) a State investment body, or a body charged with, or intervening in, the management of the public debt;
- (e) another *firm*, or an *overseas financial services institution*, except in relation to *designated investment business*, and related *ancillary activities*, conducted with or for that *firm* or institution, when that *firm* or institution is an *intermediate customer* in accordance with COB 4.1.7R (Classification of another firm or an overseas financial services institution);
- (f) any *associate* of a *firm* (except an *OPS firm*), or of an *overseas financial services institution*, if the *firm* or institution consents;
- (g) a *client* when he is classified as a *market counterparty* in accordance with COB 4.1.12R (Large intermediate customer classified as a market counterparty);

but excluding:

- (A) a *collective investment scheme*; and
- (B) a *client*, who would otherwise be a *market counterparty*, when he is classified as a *private customer* in accordance with COB 4.1.14R (Client classified as private customer);

material holding

means a holding of -

- (a) ordinary share capital and non cumulative preference share capital; or
- (b) subordinated loan and non fixed term cumulative preference share capital,

in a *credit institution* or a *financial institution* where -

- (i) (a) or (b) above exceed 10% of the share capital plus share premium of the issuer; or
- (ii) the aggregate of (a) and (b) above exceeds 10% of the *firm's own funds*, before deducting these holdings;

Material insurance

This is calculated as the higher of –

holdings (a) the book value of an investment held in an *insurance undertaking, reinsurance undertaking* or *insurance holding company*; and
(b) the group's proportionate share of that *undertaking's* local or notional regulatory requirement.

Investment for this purpose includes both a *participation* and the investment in a *subsidiary* undertaking.

member state means a country in the European Economic Area;

mixed activity holding company means a *parent* undertaking, other than a *financial holding company, an investment firm* or a *credit institution*, the *subsidiaries* of which include at least one *investment firm* or *credit institution*;

non recourse loan means a loan to a *firm* secured on specific land or buildings, under the terms of which the lender has no claim on the other assets of the *firm* nor on assets for which the *firm* is accountable in any circumstances (including a winding up);

non-core investment services means a service listed in Section C of the Annex to the ISD;

non-trading book in relation to a *firm's* business or exposures, means any position, counterparty exposure or balance sheet item not falling within the definition of *trading book* excluding its *physical commodities* and *physical commodities derivatives* business;

OECD means Organisation for Economic Co-operation and Development;

<i>open currency position</i>	Means the position calculated under 18R of appendix 8;
<i>option</i>	means a contract which confers the right to buy or sell a security, contractually based investment, currency, gold or commodity at a given price on or before a given date. (NB: the definition of an option used for the purposes of Chapter 10 of IPRU(INV) deliberately differs from that in the main Handbook Glossary);
<i>original own funds</i>	means the original own funds of a <i>firm</i> calculated in accordance with Table 10-62(2) A or B;

<i>OTC</i>	means over the counter, i.e. in relation to any <i>investment</i> , an <i>investment</i> which is not traded or listed on an exchange;
<i>out of the money</i>	means those <i>options</i> and <i>warrants</i> which are not <i>in the money</i> ;
<i>own funds</i>	means the own funds of a <i>firm</i> calculated in accordance with Table 10-61(1)B;
<i>parent</i>	means any parent undertaking as defined in section 258 of the Companies Act 1985 and any undertaking which effectively exercises a dominant influence over another undertaking;
<i>participation</i>	means a holding either direct or indirect of 20% or more of the voting rights or capital of another undertaking;
<i>partner</i>	see " <i>registered partner</i> ";
<i>passport institution</i>	means a <i>firm</i> which is an <i>incoming EEA firm</i> ;
<i>passport investment business</i>	means the carrying on by a <i>passport institution</i> , within or into the United Kingdom in accordance with Schedule 3 to the Act, of - (a) one or more <i>listed activities</i> ; or (b) one or more of the <i>core investment services</i> ; or (c) one or more of the <i>non-core investment services</i> conducted in conjunction with one or more <i>core investment services</i> ; in relation to which a <i>supervisory authority</i> in its home state has regulatory functions;
<i>payment date</i>	means the date on which payment for the <i>securities</i> is due to be made to the issuer or seller, or, if payment is made in instalments, payment of the first instalment;
<i>perfectly matching contracts</i>	mean certain <i>OTC derivatives</i> contracts which are included in a legally binding netting agreement that are equal and exact opposites and perfectly matching in all material respects;
<i>permission</i>	means a <i>permission</i> given by the <i>FSA</i> under Part IV of the <i>Act</i> (Permission to carry on regulated activities), or resulting from any other provision of the <i>Act</i> , to carry on <i>regulated activities</i> in the United Kingdom;
<i>physical commodities method</i>	means the method of calculating <i>PRR</i> under rules 10-166 to 10-169B;
<i>physical commodity</i>	means the actual commodity, <i>documents of title</i> to actual commodities or shipping documents conveying title to actual commodities;

<i>PRA</i>	means percentage risk addition, i.e. a percentage to be applied to the value of positions in <i>investments</i> held by the <i>firm</i> to determine its <i>PRR</i> ;
<i>preference securities</i>	means a <i>share</i> with rights, in respect of capital or dividends, superior to those of ordinary equity;
<i>profit shares</i>	means an appropriation of profit before tax on a predetermined basis for the benefit of management or <i>employees</i> ;
<i>PRR</i>	means the position risk requirement of a <i>firm</i> as calculated in accordance with rules 10-80, rule 10-120 and 4, 5, 6, 8, and 9;
<i>put option</i>	means an <i>option</i> to sell an <i>investment</i> , other instrument, foreign currency or <i>physical commodity</i> at a given price on or before a given date;
<i>qualifying debt security</i>	means a debt <i>security</i> which meets the conditions in 45R of appendix 4;
<i>qualifying deposit</i>	means a deposit which is one of the following - <ul style="list-style-type: none"> (a) balance on current account with an <i>approved bank</i>; (b) money on deposit with an <i>approved bank</i>, United Kingdom local authority, member of the Finance Houses Association, <i>stock exchange moneybroker</i>, <i>clearing firm</i>, the National Savings Bank, <i>recognised exchange</i> or <i>approved depository</i> which may be withdrawn within three months; (c) money on deposit with an <i>approved bank</i> directly related to a transaction creating an offsetting liability for the <i>firm</i> or subject to an agreement with the bank allowing its use as collateral for a loan that may be withdrawn within three months, which relates to a liability of the same maturity and arises out of a transaction; (d) amount evidenced by a certificate of tax deposit; (e) amount <i>evidenced by a certificate of deposit</i> issued by a <i>credit institution</i> or <i>investment firm</i> which matures within three months; or (f) deposit of cash by way of margin with an <i>exchange</i>, <i>clearing house</i>, <i>clearing firm</i> or <i>intermediate broker</i>;
<i>qualifying equity</i>	Means an <i>equity</i> which meets the conditions in 35R of appendix 5;
<i>qualifying equity index</i>	Means an <i>equity</i> index which meets the conditions in 38R of appendix 5;
<i>Regulated Activities</i>	means the Financial Services and Markets Act 2000 (Regulated

<i>Order</i>	Activities) Order 2001 (SI 2001/544);
<i>recognised clearing house</i>	means a clearing house listed as such in Appendix 57 ;
<i>recognised exchange</i>	means an exchange listed as such in Appendix 57 ;
<i>recognised investment exchange</i>	means an investment exchange which is declared by a <i>recognition order</i> for the time being in force to be a <i>recognised investment exchange</i> ; (see the list published on the FSA website at: www.fsa.gov.uk/register-res/html/prof_exchanges_fram.html .);
<i>recognised scheme</i>	means a <i>collective investment scheme</i> recognised under Chapter V of Part XVI of the <i>Act</i> ;
<i>recognised third country investment firm</i>	means an undertaking which, if it was established within the <i>EEA</i> , would be covered by the definition of <i>investment firm</i> , and which is subject to the prudential rules of one of the regulators in Appendix 59 ;
<i>reconciliation</i>	means the identification and explanation of individual items of difference between two sets of records, but does not include the processing of necessary adjustments;
<i>registered partner</i>	means a partner of any partnership (including any partnership constituted under the law of a country or territory outside the United Kingdom) which carries on <i>investment business</i> as a <i>firm</i> and who is an <i>approved person</i> ;
<i>regulated business</i>	means <i>investment business</i> which is - <ul style="list-style-type: none"> (a) business carried on from a permanent place of business maintained by a <i>firm</i> (or its <i>appointed representative</i>) in the United Kingdom; and (b) other business carried on with or for <i>customers</i> in the United Kingdom, unless that business is - <ul style="list-style-type: none"> (i) business carried on from an office of a <i>firm</i> outside the United Kingdom which, if that office were a separate person, would fall within the overseas persons exclusions set out in article 72 of the Regulated Activities Order; or (ii) business of an <i>appointed representative</i> of the <i>firm</i> which is not carried on in the United Kingdom;
<i>regulated collective investment scheme</i>	means: <ul style="list-style-type: none"> (a) an <i>ICVC</i>; or

- (b) an *AUT*; or
- (c) a *recognised scheme*;

whether or not the *units* are held within a *PEP*, *ISA*, or *pension contract*;

reporting statement

means any one or more of the following types of report as required by the *Supervision manual*:

- (a) *audited annual financial statements*;
- (b) *annual reporting statement*;
- (c) *auditor's report*;
- (d) internal control letter;
- (e) quarterly reporting statement;
- (f) position risk reporting statement;
- (g) counterparty risk reporting statement;
- (h) annual reconciliation;
- (i) monthly reporting statement; and
- (j) the audited accounts of a subsidiary of the firm;

repurchase agreement

(and "*sale and buy back agreement*") means an agreement for the sale of *securities* or *physical commodities* subject to a commitment to repurchase from the same person the same or similar *securities* or *physical commodities*, which meets either (a), (b), (c) and (e) or (a), (c), (d) and (e) of the following requirements

-
- (a) the *securities* or *physical commodities* and collateral are *marked to market* daily;
- (b) the collateral may be adjusted in order to take account of material changes in the value of the *securities* or collateral;
- (c) the agreement provides for the claims of the *firm* (*securities* or *physical commodities*) to be immediately set off against the claims of the counterparty (collateral);
- (d) the agreement is an *inter-professional* one; and
- (e) such agreements are confined to their accepted and appropriate use, and are not artificial transactions, (especially those not of a short term nature);

requirement

means a requirement included in a *firm's Part IV permission* under section 43 of the *Act* (Imposition of requirements), section 45(4) of the *Act* (Variation etc on the Authority's own initiative) or section 46 of the *Act* (Variation of permission on acquisition of control);

reverse repurchase agreement

(and “*buy and sale back agreement*”) means an agreement for the purchase of *securities* or *physical commodities* subject to a commitment to resell to the same person the same or similar *securities* or *physical commodities* which meets either (a), (b), (c) and (e) or (a), (c), (d) and (e) of the following requirements -

- (a) the *securities*, or *physical commodities*, and collateral are *marked to market* daily;
- (b) the collateral may be adjusted in order to take account of material changes in the value of the *securities*, or *physical commodities*, or collateral;
- (c) the agreement provides for the claims of the *firm* (collateral) to be immediately set off against the claims of the counterparty (*securities* or *physical commodities*);
- (d) the agreement is an *inter-professional* one; and
- (e) such agreements are confined to their accepted and appropriate use, and are not artificial transactions, (especially those not of a short term nature);

sale and buy back agreement

see *repurchase agreement*;

securities and futures firm

means a *firm* whose *permitted activities* include *designated investment business*, which is not an *authorised professional firm*, *bank*, *building society*, *credit union*, *friendly society*, *ICVC*, *insurer*, *media firm*, *service company*, *incoming EEA firm* (without a *top-up permission*), *incoming Treaty firm* (without a *top-up permission*) or *UCITS qualifier*, whose *permission* does not include a *requirement* that it comply with *IPRU(INV) 5* (Investment management firms) or 13 (Personal investment firms), and which is within (a), (b), (c) or (d):

- (a) a *firm* (other than one falling within (d)):
 - (i) which was a member of *SFA* immediately before *commencement*; and
 - (ii) which was not, immediately before *commencement*, subject to the financial supervision requirements of the *FSA* (under section 43 of the Financial Services Act 1986), *PIA* or *IMRO* under lead regulation arrangements;
- (b) a *firm* whose *permission* includes a *requirement* that it comply with *IPRU(INV) 3* or 10 (Securities and futures firms);
- (c) a *firm*:
 - (i) which was given a *Part IV permission* after

commencement, or which was authorised under section 25 of the Financial Services Act 1986 immediately before *commencement* and not a member of *IMRO*, *PIA* or *SFA*; and

- (ii) for whom the most substantial part of its gross income, including *commissions*, from the *regulated activities* included in its *Part IV permission* is derived from one or more of the following activities (based, for a *firm* given a *Part IV permission* after *commencement*, on the business plan submitted as part of the *firm's* application or, for a *firm* authorised under section 25 of the Financial Services Act 1986, on the *firm's* financial year preceding its *authorisation* under the Act):
 - (A) an activity carried on as a member of an exchange;
 - (B) making a market in *securities* or *derivatives*;
 - (C) *corporate finance business*;
 - (D) *dealing*, or *arranging (bringing about) deals in investments*, in *securities* or *derivatives*;
 - (E) the provision of clearing services as a *clearing firm*;
 - (F) *managing investments*, where those *investments* are primarily *derivatives*; and
 - (G) activities relating to *spread bets*;
- (d) a *firm* that is:
 - (i) an *ex-section 43 firm* which was not authorised under the Financial Services Act 1986 immediately before *commencement*; or
 - (ii) an *ex-section 43 lead regulated firm*;

security

means, as defined in article 3(1) of the Regulated Activities Order, any of the following investments specified in that Order:

- (a) shares (article 76);
- (b) debentures (that is, instruments creating or acknowledging indebtedness) (article 77);
- (c) government and public securities (article 78);
- (d) warrants (that is, instruments giving entitlement to investments) (article 79);

	(e) certificates representing certain securities (article 80);
	(f) units (article 81);
	(g) stakeholder pension schemes (article 82); and
	(h) rights to or interests in investments in (a) to (g) (article 89);
<i>settlement day</i>	means the day on which -
	(a) under the recognised practice of an exchange bargains are contracted for settlement; and
	(b) in the case of bargains not transacted on an exchange or entered into for forward settlement, 20 days from the date of the transaction, or, if earlier, the contractual due date;
<i>share</i>	means the investment, specified in article 76 of the Regulated Activities Order (Shares etc), which is, in summary: a share or stock in the share capital of:
	(a) any <i>body corporate</i> (wherever incorporated);
	(b) any unincorporated body constituted under the law of a country or territory outside the United Kingdom;
<i>sole trader</i>	means a <i>firm</i> which is not a <i>body corporate</i> and not a <i>partnership</i> ;
<i>stock exchange moneybroker</i>	is a moneybroker which is an <i>authorised person</i> and acts as an intermediary in the gilt market;
<i>stock financing</i>	means a transaction where a <i>physical commodity</i> is sold forward and the cost of funding is locked in until the date of the forward sale;
<i>subsidiary</i>	has the meaning given to it in section 736 of the Companies Act 1985;
<i>supervisory authority</i>	in relation to another <i>member state</i> , means an authority in that state which has regulatory functions in relation to one or more <i>listed activities, core investment services</i> or <i>non-core investment services</i> ;
<i>supranational organisation</i>	means any organisation referred to in Part 2 of Appendix 35 ;
<i>swap</i>	means a transaction in which two counterparties agree to exchange streams of payments over time according to a predetermined basis;
<i>synthetic future</i>	means a combination of a long (short) call option and a short (long) put option which are based on the same underlying and have the same notional amount, strike price and maturity;
<i>Takeover Code</i>	means the City Code on Takeovers and Mergers published by the Takeover Panel;

<i>takeover or related operation</i>	<p>means -</p> <ul style="list-style-type: none"> (a) any offer to which the <i>Takeover Code</i> applies and any transaction or arrangement which is of such a nature that the <i>Takeover Code</i> would have applied to it had it concerned a company whose shares are listed under Part VI of the <i>Act</i> and whose head office and place of central management are in the United Kingdom; (b) any offer, transaction or arrangement relating to the purchase of <i>securities</i> with a view to establishing or increasing a strategic holding of a person, or of a person together with his <i>associates</i> in the <i>securities</i> concerned; (c) any transaction or arrangement entered into in contemplation or furtherance of any offer, transaction or arrangement falling within (a) or (b) above; and (d) any transaction or arrangement entered into by way of defence or protection against any offer, transaction or arrangement falling within (a), (b) or (c) above which has taken place or which is contemplated;
<i>Takeover Panel</i>	means the Panel on Takeovers and Mergers;
<i>tender offer</i>	means an unconditional offer as a principal to buy <i>securities</i> ;
<i>trading book</i>	<p>in relation to a <i>firm's</i> business or exposures, means its -</p> <ul style="list-style-type: none"> (a) proprietary positions in <i>financial instruments</i>, <i>physical commodities</i> and commodity <i>derivatives</i> which are held for resale and/or are taken on by the <i>firm</i> with the intention of benefiting in the short term from actual and/or expected differences between their buying and selling prices, or from other price or interest-rate variations; (b) positions in <i>financial instruments</i>, <i>physical commodities</i> and commodity <i>derivatives</i> arising from matched principal broking; (c) positions taken in order to hedge other elements of the <i>trading book</i>; (d) exposures due to unsettled <i>securities</i> or <i>physical commodities</i> transactions, free deliveries, derivative transactions, <i>repurchase</i>, <i>sale and buy back</i> and <i>securities</i> and <i>physical commodities</i> lending agreements based on <i>securities</i> or <i>physical commodities</i> included in (a) to (c) above, <i>reverse repurchase</i>, <i>buy and sale back</i> and <i>securities</i> borrowing and <i>physical commodities</i> borrowing agreements based on <i>securities</i> or <i>physical commodities</i>

included in (a) to (c) above; and

(e) fees, commissions, interest and dividends which are directly related to the items included in (a) to (d) above;

trust beneficiary

means a beneficiary under a trust (not being the settlor) who benefits from the performance by a *firm* as trustee of investment services relating to the management of the trust assets;

underwriting

means an arrangement made before the relevant securities are issued under which a party agrees to buy a specified quantity of those securities on a given date and at a given price, if no other has purchased or acquired them;

undocumented buy and sale back agreement

means an agreement for the purchase of *securities* or *physical commodities* subject to a commitment to resell to the same person the same or similar *securities* or *physical commodities*, where the agreement does not meet all of the necessary requirements for a *buy and sale back agreement*, *reverse repurchase*, or *securities* borrowing or *physical commodities* borrowing agreement;

undocumented sale and buy back agreement

means an agreement for the sale of *securities* or *physical commodities* subject to a commitment to repurchase from the same person the same or similar *securities* or *physical commodities*, where the agreement does not meet all of the necessary requirements for a *sale and buy back agreement*, *repurchase*, or *securities* lending or *physical commodities* lending agreement;

venture capital business

means the business of:

- (a) investing in, advising on, managing or arranging transactions in *venture capital investments*; or
- (b) advising, managing or operating portfolios or *collective investment schemes* which (apart from funds awaiting investment) invest only in *venture capital investments*;
- (c) any *custody* activities provided in connection with the activities in (a) and (b); or
- (d) any related ancillary activities;

venture capital firm

means a *firm* whose *permission* includes a requirement that it must not conduct *investment business* other than *venture capital business*;

venture capital investment

means an *investment* which, at the time the investment is made, is:

- (a) in a new or developing company or venture; or
- (b) in a management buy-out or buy-in; or

- (c) made as a means of financing the investee company or venture and accompanied by a right of consultation, or rights to information, or board representation, or management rights; or
- (d) acquired with a view to, or in order to facilitate, a transaction falling within (a) to (c);

venture capital schemes

means a scheme for providing capital to a *body corporate* whose equity is not traded or listed on an *exchange*;

walkaway clause

means a provision which permits a non-defaulting counterparty to make only limited payments, or no payment at all, to the estate of the defaulter, even if the defaulter is a net creditor;

warrant

means the investment specified in article 79 of the Regulated Activities Order (Instruments giving entitlement to investments), which is, in summary: a warrant or other instrument entitling the holder to subscribe for a share, debenture or government and public security;

working day zero

means the working day on which the firm becomes unconditionally committed to accepting a known quantity of securities at an agreed price;

zero specific risk security

means a hypothetical debt security used to represent the general interest rate risk arising from certain derivative and forward transactions;

Zone A

see definition of *Zone A country* in the *Glossary*; and

Zone B

means any country not in *Zone A*;

Appendix 4

Interest rate PRR

General rule

- 1 R A *firm* must calculate its interest rate *PRR* by:
 - (1) identifying which positions must be included within the *PRR* calculation;
 - (2) deriving the net position in each debt *security* in accordance with 37R - 41R;
 - (3) including these net positions in the *PRR* calculation for general market risk and the *PRR* calculation for specific risk; and
 - (4) summing all *PRRs* calculated for general market risk and specific risk.
- 2 G The interest rate *PRR* calculation divides the interest rate risk into the risk of loss from a general move in market interest rates, and the risk of loss from an individual debt *security's* price changing for reasons other than a general move in market interest rates. These are called general market risk and specific risk respectively.

Scope of the Interest rate PRR calculation

- 3 R A *firm's* interest rate *PRR* calculation must:
 - (1) include all *trading book* positions in debt *securities*, *preference securities* and *convertibles*, except:
 - (a) positions in *convertibles* which have been included in the *firm's* *PRR* calculation for *equities* under appendix 5;
 - (b) positions fully deducted as *material holdings*, in which case the *firm* may exclude them; or
 - (c) positions hedging an *option* which is being treated under 26R of appendix 9; and
 - (2) include notional positions arising from *trading book* positions in the instruments listed in table 4R.
- 4 R Table: Instruments which result in notional positions (see 3R(2))

Instrument	See
<i>Futures, forwards</i> or <i>synthetic futures</i> on debt <i>securities</i>	13R
<i>Futures, forwards</i> or <i>synthetic futures</i> on debt indices or baskets	14R
Interest rate <i>futures</i> or <i>forward rate agreements (FRAs)</i>	18R
Interest rate <i>swaps</i> or foreign exchange <i>swaps</i>	21R

Deferred start interest rate <i>swaps</i> or foreign exchange <i>swaps</i>	24R
The interest rate leg of an <i>equity swap</i> (unless the <i>firm</i> calculates a <i>PRR</i> on the instrument using the basic interest rate <i>PRR</i> calculation in appendix 5)	27R
The cash leg of a <i>repurchase agreement</i> or a <i>reverse repurchase agreement</i>	30R
Cash borrowings or deposits	31R
<i>Options</i> or <i>warrants</i> on a debt <i>security</i> , interest rate or interest rate <i>future</i> or <i>swap</i> , or on a <i>future</i> on a debt <i>security</i> (unless the <i>firm</i> calculates a <i>PRR</i> on the <i>option</i> under appendix 9)	32R
Dual currency bonds	33R
Foreign exchange <i>futures</i> or <i>forwards</i>	34R
Gold <i>futures</i> or <i>forwards</i>	34R
<i>Forwards</i> , <i>futures</i> or <i>options</i> (except <i>cliquets</i>) on an <i>equity</i> , basket of <i>equities</i> or <i>equity</i> index (unless the <i>firm</i> calculates a <i>PRR</i> on the instrument using the basic interest rate <i>PRR</i> calculation in appendix 5)	34R
Credit derivatives	Appendix 63

- 5 G 3R(1) includes a *trading book* position in debt *security*, *preference security* or *convertible* that is subsequently repo'd under a *repurchase agreement* or lent under a stock lending agreement. Clearly, if the *security* had initially been obtained via a *reverse repurchase agreement* or stock borrowing agreement, the *security* would not have been included in the *PRR* calculation in the first place.
- 6 G 3R(1) includes net *underwriting* positions or reduced net *underwriting* positions in debt *securities*.
- 7 G *Firms* are reminded that table 5R in appendix 9 divides *options* and *warrants* on interest rates, debt *securities*, interest rate *futures* and *swaps* into:
- (1) those which must be treated under appendix 9; and
 - (2) those which must be treated under either appendix 4 or appendix 9, but *firms* can choose whether appendix 4 or 9 is used.
- 8 G *Cliquets* on *equities*, baskets of *equities* or *equity* indices do not attract an interest rate *PRR*. Table 4R excludes them from the scope of the interest rate *PRR* calculation in this appendix, and 45R of appendix 5 excludes them from the basic interest rate *PRR* calculation in that appendix.

- 9 G Table 4R shows that *equity derivatives* are excluded from this appendix's *PRR* calculation if they have been included in the basic interest rate *PRR* calculation in appendix 5 (see 45R of appendix 5).

Derivation of notional positions

GENERAL APPROACH

- 10 G This section converts the instruments listed in table 4R into notional positions in:
- (1) the underlying debt *security*, where the instrument depends on the price (or yield) of a specific debt *security*; and/or
 - (2) hypothetical debt *securities* to capture the pure interest rate risk arising from future payments and receipts of cash (including notional payments and receipts). Because they are designed to represent pure general market risk (and not specific risk) they are called *zero-specific-risk securities*.
- 11 R For the purposes of calculating *PRR*, unless specified otherwise, a *firm* must derive the value of notional positions as follows:
- (1) notional positions in actual debt *securities* must be valued as the nominal amount underlying the contract at the current market price of the debt *security*; and
 - (2) positions in *zero-specific-risk securities* must be valued using one of the two following methods. A *firm* must use the same method for all positions denominated in the same currency:
 - (a) Present value approach: The *zero-specific-risk security* is assigned a value equal to the present value of all the future cash flows that it represents.
 - (b) Alternative approach: The *zero-specific-risk security* is assigned a value equal to:
 - (i) the market value of the underlying notional *equity* position in the case of an *equity derivative*;
 - (ii) the notional principal amount in the case of an interest rate or foreign exchange *swap*; or
 - (iii) the notional amount of the future cash flow that it represents in the case of any other instrument.
- 12 R A *firm* must use 11R(2)(a) in respect of any positions that it includes in the duration method calculation of general market risk (see 60R).

FUTURES OR FORWARDS ON A DEBT SECURITY

- 13 R *Futures* or *forwards* on a single debt *security* must be treated as follows:

- (1) A purchased *future* or *forward* is treated as:
 - (a) a notional long position in the underlying debt *security* (or the cheapest to deliver (taking into account the conversion factor) where the contract can be satisfied by delivery of one from a range of *securities*); and
 - (b) a notional short position in a zero coupon *zero-specific-risk security* with a maturity equal to the expiry date of the *future* or *forward*.
- (2) A sold *future* or *forward* is treated as:
 - (a) a notional short position in the underlying *security* (or the cheapest to deliver (taking into account the conversion factor) where the contract can be satisfied by delivery of one from a range of *securities*); and
 - (b) a notional long position in a zero coupon *zero-specific-risk security* with a maturity equal to the expiry date of the *future* or *forward*.

FUTURES OR FORWARDS ON A BASKET OR INDEX OF DEBT SECURITIES

14 R *Futures* or *forwards* on a basket or index of debt *securities* must be converted into *forwards* on single debt *securities* as follows (and then the resulting positions are treated under 13R).

- (1) *Futures* or *forwards* on a single currency basket or index of debt *securities* must be treated as either:
 - (a) a series of *forwards*, one for each of the constituent debt *securities* in the basket or index, of an amount which is a proportionate part of the total underlying the contract according to the weighting of the relevant debt *security* in the basket; or
 - (b) a single *forward* on a hypothetical debt *security*.
- (2) *Futures* or *forwards* on multiple currency baskets or indices of debt *securities* must be treated as either:
 - (a) a series of *forwards* (using the method described in (1)(a)); or
 - (b) a series of *forwards*, each one on a hypothetical debt *security* to represent one of the currencies in the basket or index, of an amount which is a proportionate part of the total underlying the contract according to the weighting of the relevant currency in the basket.

15 G Under 14R(2)(b), a *forward* on basket of 3 Euro denominated debt *securities* and 2 Dollar denominated debt *securities* would be treated as a *forward* on a single hypothetical Euro denominated debt *security* and a *forward* on a single hypothetical Dollar denominated debt *security*.

- 16 R The hypothetical debt *securities* in 14R are assigned a specific risk *PRA* and a general market risk *PRA* equal to the highest that would apply to the debt *securities* in the basket or index.
- 17 G The debt *security* with the highest specific risk *PRA* within the basket might be a different debt *security* to that with the highest general market risk *PRA*. 16R requires a *firm* to select the highest percentages even where they relate to different debt *securities* in the basket or index, and regardless of the proportion of those debt *securities* in the basket or index.

INTEREST RATES FUTURES AND FORWARD RATE AGREEMENTS (FRAS)

- 18 R Interest rate *futures* or *FRAs* must be treated as the two notional positions (one long, one short) shown in table 19R.
- 19 R Table: Interest rate *futures* and *FRAs* (see 18R)

	1	2
	A short position in a zero coupon <i>zero-specific-risk-security</i>	A long position in a zero coupon <i>zero-specific-risk-security</i>
Where the <i>firm</i> buys an interest rate <i>future</i> or sells an <i>FRA</i>	Maturity equals the expiry date of the <i>future</i> (or settlement date of the <i>FRA</i>)	Maturity equals the expiry date of the <i>future</i> (or settlement date of the <i>FRA</i>) plus the maturity of the borrowing/deposit
Where the <i>firm</i> sells an interest rate <i>future</i> or buys an <i>FRA</i>	Maturity equals the expiry date of the <i>future</i> (or settlement date of the <i>FRA</i>) plus the maturity of the borrowing/deposit	Maturity equals the expiry date of the <i>future</i> (or settlement date of the <i>FRA</i>)

- 20 G The following example illustrates 18R and 19R in conjunction with 11R (the latter rule determines the value of notional positions). A *firm* sells £1mn notional of a 3v6 *FRA* at 6%. This results in:
- (1) a short position in a *zero-specific-risk-security* with a zero coupon, three month maturity, and a nominal amount of £1mn; and
 - (2) a long position in a *zero-specific-risk-security* with a zero coupon, six month maturity, and nominal amount of £1,015,000 (i.e. notional plus interest at 6% over 90 days).

If a *firm* were to apply the approach in 11R(2)(a), the two nominal amounts would have to be present valued.

INTEREST RATE SWAPS OR FOREIGN EXCHANGE SWAPS

- 21 R Interest rate *swaps* or foreign exchange *swaps* without deferred starts must be treated as the two notional positions (one long, one short) shown in table 22R:
- 22 R Table: Interest rate and foreign exchange *swaps* (see 21R)

	1. Paying leg A short position in a <i>zero-specific-risk security</i>	2. Receiving leg A long position in a <i>zero-specific-risk security</i>
Receiving fixed and paying floating	coupon equals the floating rate and maturity equals the reset date	Coupon equals the fixed rate of the <i>swap</i> and maturity equals the maturity of the <i>swap</i>
Paying fixed and receiving floating	coupon equals the fixed rate of the <i>swap</i> and maturity equals the maturity of the <i>swap</i>	Coupon equals the floating rate and maturity equals the reset date
Paying floating and receiving floating	coupon equals the floating rate and maturity equals the reset date	Coupon equals the floating rate and maturity equals the reset date

- 23 G For a foreign exchange *swap*, the two notional *zero-specific-risk securities* would be denominated in different currencies. A foreign exchange *swap* is also included in the foreign exchange *PRR* calculation.

DEFERRED START INTEREST RATE SWAPS OR FOREIGN EXCHANGE SWAPS

- 24 R Interest rate *swaps* or foreign exchange *swaps* with a deferred start must be treated as the two notional positions (one long, one short) shown in table 25R.

- 25 R Table: Deferred start interest rate and foreign exchange *swaps* (see 24R)

	1. Paying leg A short position in a <i>zero-specific-risk security</i> with a coupon equal to the fixed rate of the <i>swap</i>	2. Receiving leg A long position in a <i>zero-specific-risk security</i> with a coupon equal to the fixed rate of the <i>swap</i>
--	---	---

Receiving fixed and paying floating	maturity equals the start date of the <i>swap</i>	maturity equals the maturity of the <i>swap</i>
Paying fixed and receiving floating	maturity equals the maturity of the <i>swap</i>	maturity equals the start date of the <i>swap</i>

- 26 G For example, a *firm* enters into a five year *swap* which starts in two year's time. The *firm* has contracted to receive 6% and pay six month Libor on a principal amount of £1mn. This results in a long position in a 7 year debt *security* and a short position in a 2 year debt *security*. Both have a coupon of 6%.

SWAPS WHERE ONLY ONE LEG IS AN INTEREST RATE LEG (E.G. EQUITY SWAPS)

- 27 R A *firm* must treat a *swap* with only one interest rate leg as a notional position in a *zero-specific-risk security*:
- (1) with a coupon equal to that on the interest rate leg;
 - (2) with a maturity equal to the date that the interest rate will be reset; and
 - (3) which is a long position if the *firm* is receiving interest payments and short if making interest payments.
- 28 G 27R includes *equity swaps*, *commodity swaps* and any other *swap* where only one leg is an interest rate leg.

CASH LEGS OF REPURCHASE AGREEMENTS AND REVERSE REPURCHASE AGREEMENTS

- 29 G *Firm's* are reminded that for the purposes of 30R, a *repurchase agreement* includes a sell/buy back or stock lending; and a *reverse repurchase agreement* includes a buy/sell back or a stock borrowing.
- 30 R The forward cash leg of a *repurchase agreement*; or *reverse repurchase agreement*, must be treated as a notional position in a *zero-specific-risk security* which:
- (1) is a short notional position in the case of a *repurchase agreement*; and a long notional position in the case of a *reverse repurchase agreement*;
 - (2) has a value equal to the market value of the cash leg;
 - (3) has a maturity equal to that of the *repurchase agreement* or *reverse repurchase agreement*; and
 - (4) has a coupon equal to:

- (a) zero, if the next interest payment date coincides with the maturity date; or
- (b) the interest rate on the contract, if any interest is due to be paid before the maturity date.

CASH BORROWINGS AND DEPOSITS

- 31 R A cash borrowing or deposit must be treated as a notional position in a zero coupon *zero-specific-risk security* which:
- (1) is a short position in the case of a borrowing and a long position in the case of a deposit;
 - (2) has a value equal to the market value of the borrowing or deposit;
 - (3) has a maturity equal to that of the borrowing or deposit, or the next date the interest rate is reset (if earlier); and
 - (4) has a coupon equal to:
 - (a) zero, if the next interest payment date coincides with the maturity date; or
 - (b) the interest rate on the borrowing or deposit, if any interest is due to be paid before the maturity date.

OPTIONS AND WARRANTS

- 32 R Where included in this appendix's *PRR* calculation (see table 4R), *options* and *warrants* must be treated as follows:
- (1) An *option* or *warrant* on a debt *security* must be treated as a position in that debt *security*.
 - (2) An *option* on an interest rate must be treated as a position in a zero coupon *zero-specific-risk security* with a maturity equal to the sum of the time to expiry of the *option* and the length of the period for which the interest rate is fixed.
 - (3) An *option* on an *future* – where the *future* is based on an interest rate or debt *security* – must be treated as:
 - (a) a long position in that *future* for purchased call *options* and written put *options*; and
 - (b) a short position in that *future* for purchased put *options* and written call *options*.
 - (4) An *option* on a *swap* must be treated as a deferred starting *swap*.

BONDS WHERE THE COUPONS AND PRINCIPAL ARE PAID IN DIFFERENT CURRENCIES

- 33 R Where a debt *security* pays coupons in one currency, but will be redeemed in a different currency, it must be treated as:
- (1) a debt *security* denominated in the coupon's currency; and
 - (2) a foreign exchange *forward* to capture the fact that the debt *security's* principal will be repaid in a different currency from that in which it pays coupons, specifically:
 - (a) a notional forward sale of the coupon currency and purchase of the redemption currency, in the case of a long position in the debt *security*; or
 - (b) a notional forward purchase of the coupon currency and sale of the redemption currency, in the case of a short position in the debt *security*.

INTEREST RATE RISK ON OTHER FUTURES, FORWARDS AND OPTIONS

- 34 R Other *futures, forwards, options* and *swaps* must be treated as positions in *zero-specific-risk securities*, each of which:
- (1) has a zero coupon;
 - (2) has a maturity equal to that of the relevant contract; and
 - (3) is long or short according to table 35R.

- 35 R Table: Interest rate risk on other *futures, forwards, options* and *swaps* (see 34R).

Instrument	Notional positions		
Foreign exchange <i>forward</i> or <i>future</i>	a long position denominated in the	and	a short position denominated in the

	currency purchased		currency sold
Gold <i>forward</i> or <i>future</i>	a long position if the <i>forward</i> or <i>future</i> involves an actual (or notional) sale of gold	or	a short position if the <i>forward</i> or <i>future</i> involves an actual (or notional) purchase of gold
<i>Equity forward</i> or <i>future</i> , or <i>option</i> (unless a <i>PRR</i> is calculated under the basic interest rate calculation in appendix 5)	A long position if the contract involves an actual (or notional) sale of the underlying <i>equity</i>	or	A short position if the contract involves an actual (or notional) purchase of the underlying <i>equity</i>

Deriving the net position in each debt security

- 36 G The net position is the difference between the value of the *firm*'s long positions (including notional positions) and the value of its short positions (including notional positions) in the same debt *security*.

NETTING POSITIONS IN THE SAME DEBT SECURITY

- 37 R A *firm* must not net positions (including notional positions) unless:
- (1) Long and short positions are in the same debt *security*, and a debt *security* is the same as another if and only if:
 - (a) they enjoy the same rights in all respects; and
 - (b) are fungible with each other;
 - (2) Long and short positions are in different tranches of the same debt *security*, where the tranches:
 - (a) enjoy the same rights in all respects; and
 - (b) become fungible within 180 days, and thereafter the debt *security* of one tranche can be delivered in settlement of the other tranche.

NETTING THE CHEAPEST TO DELIVER SECURITY WITH OTHER DELIVERABLE SECURITIES

- 38 R A *firm* may net a short notional position in the cheapest to deliver *security* arising from a short *future* or *forward* (see 13R(2)(a)) against a long position in any deliverable *security* up to a maximum of 90% of the common nominal amounts. The residual long and short nominal amounts must be treated as separate long and short positions.

- 39 G The netting permitted by 38R only relates to where the *firm* has sold the *future* or *forward*. It does not relate to where the *firm* has bought a *future* or *forward*.

NETTING ZERO-SPECIFIC-RISK SECURITIES WITH DIFFERENT MATURITIES

- 40 R A *firm* may net a notional long position in a *zero-specific-risk security* against a notional short position in a *zero-specific-risk security* if:
- (1) they are denominated in the same currency;
 - (2) their coupons do not differ by more than 15 basis points; and
 - (3) they mature:
 - (a) on the same day, if they have residual maturities of less than one month;
 - (b) within seven days of each other, if they have residual maturities of between one month to one year; and
 - (c) within thirty days of each other, if they have residual maturities in excess of one year.

REDUCED NET UNDERWRITING POSITIONS IN DEBT SECURITIES

- 41 R A *firm* must not net a reduced net *underwriting* position in a debt *security* with any other debt *security* position.
- 42 G 41R only relates to reduced net *underwriting* positions.

Specific risk calculation

- 43 R A *firm* must calculate the specific risk *PRR* for each debt *security* by:
- (1) multiplying the market value of the individual net position (ignoring the sign) by the appropriate *PRA* from table 44R; and
 - (2) converting this amount into the *firm's base currency* at prevailing spot foreign exchange rates.
- 44 R Table: specific risk *PRAs* (see 43R).

Issuer	Residual maturity	<i>PRA</i>
An issue of, or fully guaranteed by, or fully collateralised by a <i>Zone A</i> central government or central bank or the European Communities	Any	0%

An issue of, or fully guaranteed by, a <i>Zone B</i> central government or central bank denominated in the local currency	Zero to 12 months	0%
Other <i>qualifying debt securities</i> (see 46R)	Zero to 6 months	0.25%
	6 to 24 months	1%
	Over 24 months	1.6%
Non- <i>qualifying debt securities</i>	Any	8%

45 G 43R includes both actual and notional positions. However, notional positions in *zero-specific-risk securities* do not attract specific risk. For example:

- (1) Interest rate *swaps*, foreign exchange *swaps*, *FRAs*, interest rate *futures*, foreign exchange *forwards*, foreign exchange *futures*, and the cash leg of *repurchase agreements* and *reverse repurchase agreements* create notional positions which will not attract specific risk; whilst
- (2) *Futures*, *forwards* and *swaps* which are based on the price (or yield) of one or more debt *securities* will create at least one notional position that attracts specific risk.

DEFINITION OF A QUALIFYING DEBT SECURITY

46 R A debt *security* is a *qualifying debt security* if:

- (1) it attracts zero specific risk under table 44R; or
- (2) it is issued by, or fully guaranteed by:
 - (a) a *Zone B* central government or central bank and the *security* is denominated in the local currency of the issuer;
 - (b) a *multilateral development bank*;
 - (c) a *Zone A* public sector entity;
 - (d) a company whose *equity* is a constituent of one of the indices making up the FTSE All-World Index; or
 - (e) an issue of, or fully guaranteed by an *investment firm* or *recognised third-country investment firm*.
- (3) it is issued by, fully guaranteed by, endorsed or accepted by:

- (a) a *credit institution* incorporated in a *Zone A* country; or
 - (b) a *credit institution* incorporated in a *Zone B* country and the debt *security* has a residual maturity of one year or less.
- (4) it is a mortgage backed *security* relating to residential real estate of the type referred to in BIPRU 3.4.94R(1)(d)(i) which meets the requirements about legal certainty referred to in BIPRU 3.4.62R.
- (5) it is rated by at least one of the agencies shown in table 47R, and every such rating equals or exceeds the corresponding minimum shown in that table.

47 R Table: minimum ratings for *qualifying debt securities* (see 46R(5)).

Issuer	Rating agency	Minimum Rating	
		<i>Securities</i>	Money Market Obligations
Any	Moody's Investors Service	Baa3	P3
	Standard & Poor's Corporation	BBB-	A3
	FITCH Ratings Ltd	BBB-	F-3
Canadian	Canadian Bond Rating Service	B++low	A-3
	Dominion Bond Rating Service	BBB low	R-2
Japanese	Japan Credit Rating Agency, Ltd	BBB-	J-2
	Mikuno & Co	BBB	M-3
	Japan Rating & Investment Information Inc	BBB-	a-2

General market risk calculation

- 48 R A *firm* must calculate the general market risk *PRR* for each currency using either:
- (1) the simplified maturity method;
 - (2) the maturity method; or
 - (3) the duration method (subject to 50R).
- 49 R A *firm* must convert all general market risk *PRRs* into its *base currency* using prevailing foreign exchange spot rates.
- 50 R A *firm* must not use the duration method for index-linked *securities*. Instead, these *securities* must:
- (1) be attributed a coupon of 3%; and

- (2) treated separately under either the simplified maturity method or the maturity method.

SIMPLIFIED MATURITY METHOD

- 51 G The simplified maturity method weights individual net positions to reflect their price sensitivity to changes in interest rates. The weights are related to the coupon and the residual maturity of the instrument (or the next interest rate re-fix date for floating rate items).
- 52 R Under the simplified maturity method, the *PRR* for general market risk equals the sum of each individual net position (long or short) multiplied by the appropriate *PRA* in table 53R.
- 53 R Table: general market risk *PRAs* (see 52R).

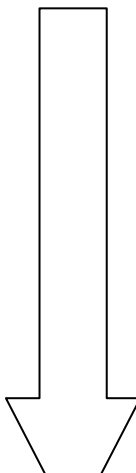
Zone	Maturity band		<i>PRA</i>
	Coupon of 3% or more	Coupon of less than 3%	
One	$0 \leq 1$ month	$0 \leq 1$ month	0.00%
	$> 1 \leq 3$ months	$> 1 \leq 3$ months	0.20%
	$> 3 \leq 6$ months	$> 3 \leq 6$ months	0.40%
	$> 6 \leq 12$ months	$> 6 \leq 12$ months	0.70%
Two	$> 1 \leq 2$ years	$> 1.0 \leq 1.9$ years	1.25%
	$> 2 \leq 3$ years	$> 1.9 \leq 2.8$ years	1.75%
	$> 3 \leq 4$ years	$> 2.8 \leq 3.6$ years	2.25%
Three	$> 4 \leq 5$ years	$> 3.6 \leq 4.3$ years	2.75%
	$> 5 \leq 7$ years	$> 4.3 \leq 5.7$ years	3.25%
	$> 7 \leq 10$ years	$> 5.7 \leq 7.3$ years	3.75%
	$> 10 \leq 15$ years	$> 7.3 \leq 9.3$ years	4.50%
	$> 15 \leq 20$ years	$> 9.3 \leq 10.6$ years	5.25%
	> 20 years	$> 10.6 \leq 12.0$ years	6.00%
		$> 12.0 \leq 20.0$ years	8.00%
		> 20 years	12.50%

THE MATURITY METHOD

- 54 G The maturity method builds on the simplified maturity method by partially recognising offsetting positions. 57G provides an illustration of the maturity method.
- 55 R Under the maturity method, the *PRR* for general market risk is calculated as follows:
- (1) Step 1: each net position is allocated to the appropriate maturity band in table 53R and multiplied by the corresponding *PRA*.
 - (2) Step 2: weighted long and short positions are matched within:
 - (a) the same maturity band;

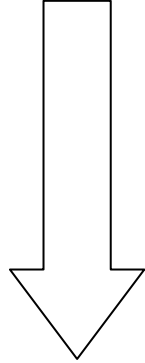
- (b) the same zone (using unmatched positions from (a)); and
 - (c) different zones (using unmatched positions from (b)).
- (3) Step 3: the *PRR* for general market risk is the sum of:
- (a) 10% of the total amount matched within maturity bands;
 - (b) 40% of the amount matched within zone 1 under (2)(b);
 - (c) 30% of the amount matched within zones 2 & 3 under (2)(b);
 - (d) 40% of the amounts matched between zones 1 and 2, and between zones 2 and 3;
 - (e) 150% of the amount matched between zones 1 and 3; and
 - (f) 100% of the weighted positions remaining unmatched after (2)(c);
- 56 G Table 53R distinguishes between debt *securities* with a coupon of less than 3% and those with coupon in excess of 3%. However, this doesn't mean that the *firm* has to do a separate general market risk calculation for each, it merely ensures that when allocating debt *securities* to a particular band, their coupons are taken into account as well as their maturities. So for example, a 21 year 6% debt *security* falls into the same band as an 11 year 2% debt *security*. They are both weighted at 6%, and can be matched under the first part of step two because they fall within the same band.
- 57 G An example of the maturity method calculation. In this example, a *firm* with a £ sterling *base currency* is processing its euro denominated positions.

Weight
each
position



Zone	Totals of:		<i>PRA</i>		Weighted longs within each band	Weighted shorts within each band
	net longs within the band	net shorts within the band				
1	€100	€50	0.00%		0	0
	€250	€0	0.20%		0.50	0
	€200	€0	0.40%		0.80	0
	€0	€0	0.70%		0	0
2	€140	€0	1.25%		1.75	0
	€200	€300	1.75%		3.50	5.25
	€0	€400	2.25%		0	9
3	€0	€0	2.75%		0	0
	€200	€200	3.25%		6.50	6.50
	€300	€0	3.75%		11.25	0
	€200	€300	4.50%		9	13.50
	€0	€14.30	5.25%		0	0.75
	€300	€0	6.00%		18.00	0
	€0	€0	8.00%		0	0
	€0	€0	12.50%		0	0

Match weighted positions



Calculate the general market risk

same band		same zones		different zones	
Long	Short	Long	Short	Long	Short
0.50		0.50		1.30	
0.80		0.80			
1.75		1.75			
3.50 ← → 5.25		← 1.75 →			9.00
	9		9		
6.50 ← → 6.50					
11.25		11.25		24.00	
9 ← → 13.50		← 4.50 →			
	0.75	→ 0.75			
18.00		18.00			
19 matched		7 matched		9 matched	

Matched within bands	19	@	10%	=	1.9
Matched within zone 1	0	@	40%	=	0
Matched within zones 2&3	7	@	30%	=	2.1
Matched between zones 1&2 and 2&3	9	@	40%	=	3.6
Matched between zones 1&3	0	@	150%	=	0
Unmatched after 2(c)	16.30	@	100%	=	16.30
total = € 23.90					
general market risk PRR (if €1=£0.60) = £14.34					

DURATION METHOD

- 58 G The duration method produces a more accurate measure of interest rate risk than the maturity methods but it is also more complex to calculate.
- 59 R *Firms* must use the following formula to calculate modified duration:

$$\text{Modified Duration} = \frac{D}{(1+r)} \qquad D = \frac{\sum_{t=1}^m \frac{tC_t}{(1+r)^t}}{\sum_{t=1}^m \frac{C_t}{(1+r)^t}}$$

Where: C_t = cash payment at time t
 m = total maturity

r = yield to maturity, based on the current mark to market of the debt *security*. In the case of a floating rate instrument, this is calculated on the assumption that the principal is due on the date that the interest rate can next be changed

t = time

- 60 R Under the duration method, the *PRR* for general market risk is calculated as follows:
- (1) Step 1: allocate each net position to the appropriate duration zone in table 61R and multiply it by:
 - (a) its modified duration (using the formula in 59R); and
 - (b) the appropriate assumed interest rate change in table 61R.
 - (2) Step 2: match weighted long and short positions:
 - (a) within zones; and
 - (b) across zones (using unmatched positions from (2)(a)); and
 - (3) Step 3: calculate the general market risk as the sum of:
 - (a) 100% of the weighted positions remaining unmatched after (2)(b);
 - (b) 2% of the matched weighted position in each zone;
 - (c) 40% of the matched weighted position between zones 1 and 2, and between zones 2 and 3; and
 - (d) 150% of the matched weighted position between zones 1 and 3.

61 R Table: Assumed interest rate change in the duration method (see 60R).

Zone	Modified Duration	Assumed interest rate change (percentage points)
1	$0 \leq 12$ months	1.00
2	> 12 months ≤ 3.6 years	0.85
3	> 3.6 years	0.70

Appendix 5

Equity PRR

General rule

- 1 R A *firm* must calculate its *equity PRR* by:
- (1) identifying which *equity* positions must be included within the scope of the *PRR* calculation (see 2R);
 - (2) deriving the net position in each *equity* in accordance with 23R;
 - (3) including each of those net positions in either the simplified equity method (see 29R) or, subject to 27R, the standard equity method (see 32R); and
 - (4) summing the *PRR* on each net position as calculated under the simplified and standard equity methods.

Scope of the Equity PRR calculation

- 2 R A *firm's equity PRR* calculation must:
- (1) Include all *trading book* positions in *equities*, unless:
 - (a) the position is fully deducted as a *material holding*, in which case the *firm* may exclude it;
 - (b) the position is hedging an *option* or *warrant* which is being treated under 26R of appendix 9; and
 - (2) include notional positions arising from *trading book* positions in the instruments listed in table 3R.
- 3 R Table: Instruments which result in notional positions (see 2R(2))

Instrument	See
Depository receipts	12R
<i>Convertibles</i> where: (a) the <i>convertible</i> is trading at a market price of less than 110% of the underlying <i>equity</i> ; and the first date at which conversion can take place is less than three months ahead, or the next such date (where the first has passed) is less than a year ahead; or (b) the conditions in (a) are not met but the <i>firm</i> includes the <i>convertible</i> in its <i>equity PRR</i> calculation rather than including it in its interest rate <i>PRR</i>	13R

	calculation set out in appendix 4.	
	<i>Futures, forwards, CFDs and synthetic futures on a single equity</i>	14R
	<i>Futures, forwards, CFDs and synthetic futures on a basket of equities or equity index</i>	15R
	<i>Equity legs of an equity swap</i>	19R
	<i>Options or warrants on a single equity, an equity future, a basket of equities or an equity index (unless the firm calculates a PRR on the option or warrant under appendix 9).</i>	21R

- 4 G 2R(1) includes a *trading book* position in an *equity* that is subsequently repo'd under a *repurchase agreement* or lent under a stock lending agreement. Clearly, if the *equity* had initially been obtained via a *reverse repurchase agreement* or stock borrowing agreement, the *equity* would not have been included in the *trading book* in the first place.
- 5 G 2R(1) includes net *underwriting* positions, or reduced net *underwriting* positions in *equities*. 27R requires *firms* to use the simplified equity method in the case of reduced net *underwriting* positions. In the case of net *underwriting* positions that haven't been reduced according to 24R of appendix 7, there is no such restriction; a *firm* can choose which of the two equity methods to use.
- 6 G *Firms* are reminded that table 5R in appendix 9 divides *equity options* and *warrants* into:
- (1) those which must be treated under appendix 9; and
 - (2) those which must be treated under either appendix 5 or appendix 9, but *firms* can choose whether appendix 5 or 9 is used.
- 7 G Table 3R doesn't require every *convertible* to be included in this appendix's *PRR* calculation. Where a *convertible* is not included in this appendix's *PRR* calculation, 3R(1)(a) of appendix 4 requires that it is included in the appendix 4 *PRR* calculation.
- 8 G Some of the instruments listed in table 3R are also included in a *firm's* interest rate *PRR* calculation. For simplicity, a *firm* may use the interest rate *PRR* calculation at the end of this appendix rather than the calculation in appendix 4. 44G explains this in more detail.

Derivation of notional positions

- 9 G This section converts the instruments listed in table 3R into notional positions in individual *equities*, *equity* baskets or *equity* indices.

GENERAL RULE

- 10 R Unless specified otherwise, the value of each notional *equity* position equals the quantity of that *equity* underlying the instrument multiplied by the current market value of the *equity*.

- 11 G For example, the current market value of a particular *equity* is £2.50. If a *firm* contracts to sell this *equity* in five year's time for £3 it would treat the notional short *equity* position as having a value of £2.50 when calculating the *equity PRR*.

In effect, the forward position has been treated as being equivalent to a spot position for the purposes of calculating *equity PRR*. To capture the risk that the forward price changes relative to the spot price, forward *equity* positions are included in the *firm's* interest rate *PRR* calculation (see 45R of this appendix or table 4R of appendix 4).

DEPOSITORY RECEIPTS

- 12 R A depository receipt must be treated as a notional position in the underlying *equity*.

CONVERTIBLES

- 13 R Where a *convertible* is included in this appendix's *PRR* calculation (see table 3R):
- (1) it must be treated as a position in the *equity* into which it converts; and
 - (2) the *firm's equity PRR* must be adjusted by making:
 - (a) an addition equal to the current value of any loss which the *firm* would make if it did convert to *equity*; or
 - (b) a deduction equal to the current value of any profit which the *firm* would make if it did convert to *equity* (subject to a maximum deduction equal to the *PRR* on the notional position underlying the *convertible*).

FUTURES, FORWARDS AND CFDS ON A SINGLE EQUITY

- 14 R A *future, forward* or *CFD* on a single *equity* must be treated as a notional position in that *equity*.

FUTURES, FORWARDS AND CFDS ON EQUITY INDICES OR BASKETS

- 15 R A *future, forward* or *CFD* on an *equity* index or basket must be treated as either:
- (1) a position in each of the underlying *equities*; or
 - (2) the positions shown in table 16R.
- 16 R Table: *equity* index or basket contracts (see 15R(2))

	Under the simplified equity method (29R)	Under the standard equity method (32R)
Only one country in the index or	One position in the index or	One position in the index or basket

basket (see 32R)	basket		
More than one country in the index or basket	One position in the index or basket	Several notional basket positions, one for each country	Or One notional basket position in a separate, hypothetical country

- 17 G For example, a *firm* decides to treat a FTSE Eurotop 300 *future* under the standard equity method, and furthermore, chooses to treat it as one notional position. Table 16R requires that this notional position must be treated as if it were from a separate hypothetical “country” rather than any of the countries to which the underlying *equities* are from.
- 18 R The notional positions created under 15R have the following values:
- (1) where only one notional position is created, it has a value equal to the total market value of the *equities* underlying the contract; or
 - (2) where more than one notional position is created, each one has a value which reflects the relevant *equity's* or country's contribution to total market value of the *equities* underlying the contract.

EQUITY LEGS OF EQUITY SWAPS

- 19 R The *equity* leg of an *equity swap* must be treated as a position in the underlying *equity*, *equity* basket or *equity* index, which is:
- (1) long, if the *firm* has contracted to receive any increase and pay any decrease in the value of the underlying *equities* or *equity* index; and
 - (2) short, if the *firm* has contracted to receive any decrease and pay any increase in the value of the underlying *equities* or *equity* index.
- 20 G The interest rate leg of an *equity swap* is included in a *firm's* interest rate *PRR* calculation (see table 4R of appendix 4).

OPTIONS

- 21 R If included in this appendix's *PRR* calculation (see table 3R), *options* must be treated as follows:
- (1) an *option* on a single *equity* must be treated as a notional position in that *equity*;
 - (2) an *option* on a basket of *equities* or *equity* index must be treated as a *future* on that basket or index; and
 - (3) an *option* on an *equity future* must be treated as:
 - (a) a long position in that *future*, for purchased *call options* and written *put options*; and

- (b) a short position in that *future*, for purchased *put options* and written *call options*.

Deriving the net position in each equity

- 22 G The net position is the difference between the value of the *firm*'s long positions (including notional positions) and the value of its short positions (including notional positions) in the same *equity*.
- 23 R When deriving the net position in each *equity*, a *firm* must not net long and short positions unless:
 - (1) they are positions in the same *equity*. Two *equities* are the same if:
 - (a) they enjoy the same rights in all respects; and
 - (b) are fungible with each other; or
 - (2) they are positions in different tranches of the same *equity* and the tranches:
 - (a) enjoy the same rights in all respects; and
 - (b) become fungible for each other within 180 days, and thereafter the *equity* of one tranche can be delivered in settlement of the other tranche.
- 24 R A *firm* must not net a reduced net *underwriting* position with any other *equity* position.
- 25 G 24R only relates to reduced net *underwriting* positions.

Simplified and standard equity methods

- 26 G 1R(3) requires that the net position in each *equity* is included in either the simplified equity method or the standard equity method, though indicates that this choice is subject to the restriction in 27R. A *firm* does not have to use the same method for all *equities*.
- 27 R A *firm* must use the simplified equity method for reduced net *underwriting* positions.
- 28 G A *firm* may use either method for a net *underwriting* position; 27R only relates to reduced net *underwriting* positions.

SIMPLIFIED EQUITY METHOD

- 29 R Under the simplified method, the *PRR* for each *equity*, *equity* index, or *equity* basket equals the market value of the net position (ignoring the sign) multiplied by the appropriate *PRA* from table 30R. The result must be converted into the *firm*'s *base currency* at current spot foreign exchange rates.
- 30 R Table: simplified equity method *PRAs* (see 29R)

PRA

Single <i>equities</i>	12%
<i>Qualifying equity indices</i> (see 38R)	8%
All other <i>equity</i> indices or baskets	12%
	Standard equity method

31 G The standard equity method divides the risk of loss from a *firm's equity* positions into the risk of loss from a general move in that country's *equity* market and the risk of loss from an individual *equity's* price changing relative to that country's *equity* market. These are called general market risk and specific risk respectively.

32 R Under the standard equity method, a *firm* must:

(1) Group *equity* positions into country portfolios as follows:

(a) A position in an individual *equity* belongs to:

- (i) the country it is listed in;
- (ii) any of the countries it is listed in, if more than one; or
- (iii) the country it was issued from, if unlisted.

(b) A position in *equity* basket or index that is treated under 15R(2), is allocated to one or more country portfolios based on the countries to which the underlying *equities* belong to under (a) above.

(2) Sum:

(a) the *PRRs* for specific risk calculated under 33R; and

(b) the *PRRs* for general market risk for each country portfolio as calculated under 41R and 42R.

STANDARD EQUITY METHOD: SPECIFIC RISK

33 R Under the standard equity method, a *firm* must calculate a *PRR* for specific risk based on the net position in each *equity*, *equity* index or *equity* basket by:

- (1) multiplying its market value (ignoring the sign) by the appropriate *PRA* from table 34R; and
- (2) converting it into the *firm's base currency* using current spot foreign exchange rates.

34 R Table: *PRAs* for specific risk under the standard approach (see 33R(1))

	PRA
<i>Qualifying equities</i> (see 35R)	2%

<i>Qualifying equity indices</i> (see 38R)	0%
All other <i>equities</i> , <i>equity</i> indices or <i>equity</i> baskets	4%

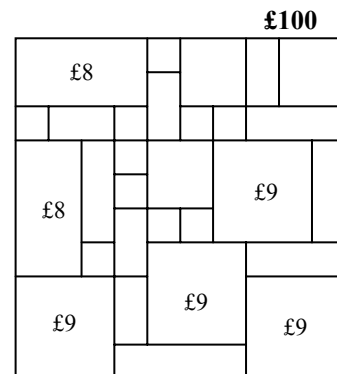
- 35 R For the purposes of table 34R, a *qualifying equity* is one which:
- (1) belongs to a country portfolio where:
 - (a) no individual position exceeds 10% of the portfolio's gross value; and
 - (b) the sum of positions (ignoring the sign) which individually represent between 5% and 10% of the portfolio's gross value, does not exceed 50% of the portfolio's gross value; and
 - (2) is a constituent of an index in table 39R.

- 36 G The following example illustrates 35R(1). A country portfolio has a gross value of £100 and is made up of positions in 29 different *equities* (some are long positions, others are short positions). Not all the *equities* are constituents of an index used to create the FT All-World Index (this criterion only becomes relevant once a *firm* has determined whether the country portfolio meets the test in 35R(1)).

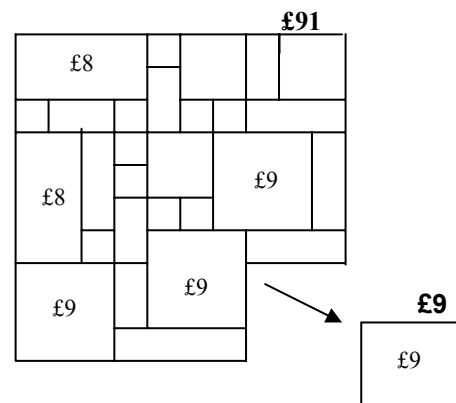
Six positions exceed the 5% threshold. The diagram below shows the composition of the portfolio.

Part (a): the portfolio meets the first part of the test because no individual position is worth more than 10% of the portfolio's value.

Part (b): the portfolio fails the second part of the test because the sum (ignoring the sign) of the six relevant positions is £52; this exceeds 50% of the portfolio's value.



- 37 G A country portfolio can be split into two sub-portfolios if this enables one sub-portfolio to meet the requirements in 35R. Individual positions may be sub-divided between sub-portfolios.



Continuing the example above, one of the largest positions is taken out of the portfolio and put into a new portfolio. The new portfolio fails the two tests, but the amended portfolio meets both tests:

Part (a): no single remaining position exceeds £9.10.

Part (b): the sum of the five relevant positions is £43, this is less than 50% of the new portfolio's value of £91.

38 R A *qualifying equity index* is one which:

- (1) is listed in table 39R; or
- (2) is not listed in table 39R, but is constructed such that:
 - (a) it contains at least 20 *equities*;
 - (b) no single *equity* represents more than 20% of the total index; and
 - (c) no five *equities* combined represent more than 60% of the total index.

39 R Table: *Qualifying equity indices* (see 38R)

Qualifying equity indices	
Australia	All Ordinaries
Austria	Austrian Traded Index
Belgium	BEL 20
Canada	TSE 35, TSE 100, TSE 300
France	CAC 40, SBF 250
Germany	DAX
European	Dow Jones Stoxx 50 Index, FTSE Eurotop 300, MSCI Euro Index
Hong Kong	Hang Seng 33
Italy	MIB 30
Japan	Nikkei 225, Nikkei 300, TOPIX
Korea	Kospi
Netherlands	AEX
Singapore	Straits Times Index
Spain	IBEX 35
Sweden	OMX
Switzerland	SMI
UK	FTSE 100, FTSE Mid 250, FTSE All Share
US	S&P 500, Dow Jones Industrial Average, NASDAQ Composite,

	Russell 2000
	Standard equity method: general market risk

- 40 R Under the standard equity method, a *firm* must apply approach one to each country portfolio (or part portfolio) unless the conditions in 42R are met, in which case the *firm* may instead apply approach two to the relevant country portfolios (or part portfolios).

APPROACH ONE: NO OFFSET BETWEEN DIFFERENT COUNTRY PORTFOLIOS

- 41 R Under approach one, the *PRR* for general market risk equals the net value (ignoring the sign) of the country portfolio multiplied by 8%. It must be converted into the *firm's base currency* using current spot foreign exchange rates.

APPROACH TWO: LIMITED OFFSET BETWEEN DIFFERENT COUNTRY PORTFOLIOS

- 42 R Under approach two, the *PRR* for general market risk is calculated using the following formula:

$$\sqrt{(8\% * CP_1)^2 + (8\% * CP_2)^2 + (8\% * CP_3)^2 + \dots + (8\% * CP_n)^2}$$

where CP_i denotes the net value of *i*th country portfolio (converted to the *firm's base currency* using current spot foreign exchange rates), and:

- (1) at least four country portfolios are included (that is: $n \geq 4$);
- (2) only country portfolios for countries which are full members of the *OECD*, Hong Kong or Singapore are included;
- (3) no individual country portfolio comprises more than 30% of the total gross value of country portfolios included; and
- (4) the total net value of country portfolios included equals zero, that is:

$$\sum_1^n CP_i = 0$$

- 43 G In order to meet 42R(4), it is likely that part of a country portfolio will have to be excluded from approach two (and therefore included in approach one), even if that country portfolio meets (1) to (3).

Basic interest rate *PRR* calculation for equity instruments

- 44 G A basic *PRR* calculation is included in this appendix for those *firms* that do not wish to use the calculation in appendix 4. However, it tends to result in higher charges than the methods in appendix 4, largely because the interest rate *PRR* is calculated on each notional equity position separately and then summed without offsetting long and short positions.

- 45 R Where a *firm* does not include a *forward*, *future*, or *option* (except cliquets) or *swap* on an *equity*, basket of *equities* or *equity* index in its appendix 4 *PRR* calculation, it must calculate an interest rate *PRR* as follows:
- (1) multiplying the market value of the notional *equity* position underlying the instrument by the appropriate percentage from table 47R; and
 - (2) summing the results from (1), ignoring the sign.
- 46 G Cliquets on *equities*, baskets of *equities* or *equity* indices do not attract an interest rate *PRR*. 45R excludes them from the basic interest rate *PRR* calculation and table 4R excludes them from the scope of the interest rate *PRR* calculation in appendix 4.
- 47 R Table: Percentages used in the basic interest rate *PRR* calculation for equity instruments (see 45R(1)).

Time to expiration	Percentage
$0 \leq 3$ months	0.20
$> 3 \leq 6$ months	0.40
$> 6 \leq 12$ months	0.70
$> 1 \leq 2$ years	1.25
$> 2 \leq 3$ years	1.75
$> 3 \leq 4$ years	2.25
$> 4 \leq 5$ years	2.75
$> 5 \leq 7$ years	3.25
$> 7 \leq 10$ years	3.75
$> 10 \leq 15$ years	4.50
$> 15 \leq 20$ years	5.25
> 20 years	6.00

Appendix 6

Commodity PRR

General rule

- 1 R A *firm* must calculate its *commodity PRR* by:
- (1) identifying which *commodity* positions must be included within the scope of the *PRR* calculation (see 2R);
 - (2) calculating an individual *PRR* for each *commodity* (see 20R);
 - (3) converting each *PRR* to the *firm's base currency* at current spot foreign exchange rates; and
 - (4) summing the resulting individual *PRRs*.

Scope of the commodity PRR calculation

- 2 R A *firm's commodity PRR* calculation must, regardless of whether the positions concerned are *trading book* or *non-trading book* positions:
- (1) include *physical commodity* positions;
 - (2) include notional positions arising from positions in the instruments listed in table 4R; and
 - (3) exclude positions constituting a *stock financing* transaction.
- 3 G Gold positions are excluded from the scope of the *commodity PRR*. Instead, they are included within the scope of the foreign exchange *PRR* (Appendix 8).
- 4 R Table: Instruments which result in notional positions (see 2R(3))

<i>Forwards, futures, CFDs, synthetic futures and options</i> on a single <i>commodity</i> (unless the <i>firm</i> calculates an <i>PRR</i> on the <i>option</i> under appendix 9)	8R
A commitment to buy or sell a single <i>commodity</i> at an average of spot prices prevailing over some future period	10R
<i>Forwards, futures, CFDs, synthetic futures and options</i> on a <i>commodity index</i> (unless the <i>firm</i> calculates an <i>PRR</i> on the <i>option</i> under appendix 9)	13R – 14R
<i>Commodity swaps</i>	16R – 17R

- 5 G 2R includes a *trading book* position in an *commodity* that is subsequently repo'd under a *repurchase agreement* or lent under a stock lending agreement. Clearly, if the *commodity* had initially been obtained via a *reverse repurchase agreement* or stock borrowing agreement, the *commodity* would not have been included in the *trading book* in the first place.
- 6 G *Firms* are reminded that table 5R in appendix 9 divides *commodity options* into:
- (1) those which must be treated under appendix 9; and
 - (2) those which must be treated under either appendix 6 or appendix 9, but *firms* can choose whether appendix 6 or 9 is used.

Derivation of notional positions

- 7 G This section converts the instruments listed in table 4R into notional positions in the relevant *commodities*. These notional positions are expressed in terms of quantity (tonnes, barrels, etc), not value. The maturity of the position is only relevant where the *firm* is using the maturity ladder approach or the modified maturity ladder approach.

Futures, forwards, CFDs and options on a single commodity

- 8 R Where a *forward, future, CFD, synthetic future* or *option* (unless already included in the *firm's option PRR* calculation) settles according to:
- (1) the difference between the price set on trade date and that prevailing at contract expiry, the notional position:
 - (a) equals the total quantity underlying the contract; and
 - (b) has a maturity equal to the expiry date of the contract
 - (2) the difference between the price set on trade date and the average of prices prevailing over a certain period up to contract expiry, there is a notional position for each of the reference dates used in the averaging period to calculate the average price, which:
 - (a) equals a fractional share of the total quantity underlying the contract; and
 - (b) has a maturity equal to the relevant reference date.
- 9 G The following example illustrates 8R(2). A *firm* buys a Traded Average Price Option (TAPO - a type of Asian option) allowing it to deliver 100 tonnes of Grade A copper and receive \$1,750 in June. If there were twenty *business days* in June the short notional positions will each:
- (1) equal 5 tonnes per day (1/20 of 100 tonnes); and
 - (2) have a maturity equal to one of the *business days* in June (one for each day).

In this example as each *business day* in June goes by the quantity per day for the remaining days does not change (5 tonnes per day) only the days remaining changes. Therefore, halfway through June there are 10, 5 tonne short notional positions remaining each for the ten remaining *business days* in June.

Buying or selling a single commodity at an average of spot prices prevailing in the future

- 10 R Commitments to buy or sell at the average spot price of the *commodity* prevailing over some period between trade date and maturity must be treated as a combination of:
- (1) a position equal to the full amount underlying the contract with a maturity equal to the maturity date of the contract which is:
 - (a) long, where the *firm* will buy at the average price; or
 - (b) short, where the *firm* will sell at the average price
 - (2) a series of notional positions, one for each of the reference dates where the contract price remains unfixed, each of which:
 - (a) is long if the position under (1) is short, or short if the position under (1) is long;
 - (b) equals a fractional share of the total quantity underlying the contract; and
 - (c) has a maturity date of the relevant reference date.

- 11 G The following guidance provides an example of 10R.

In January, a *firm* agrees to buy 100 tonnes of copper for the average spot price prevailing during the 20 *business days* in February, and will settle on 30 June. After entering into this agreement, the *firm* faces the risk that the average price for February increases relative to that for 30 June. Therefore, as highlighted in the table below:

- (1) the short positions reflect the fact that this could occur because any one of the remaining forward prices for February increase; and
- (2) the long position reflects the fact that this loss could occur because the forward price for 30 June falls.

- 12 G Table: Example of buying at the average spot price prevailing in the future (see 11G)

	Application of 10R(1)	Application of 10R(2)
From trade date to start of averaging period	Long position in 100 tonnes of copper with a maturity of 30 June.	A series of 20 notional short positions each equal to 5 tonnes of copper. Each position is allocated a maturity equal to one of the <i>business days</i> in February (one for each day).
During averaging period	Long position in 100 tonnes of copper with a maturity of 30 June.	As each <i>business day</i> goes by in February the price for 5 tonnes of copper is fixed and so there will be one less notional short position.
After averaging period	Long position in 100 tonnes of copper with a maturity of 30 June.	No short positions.

Futures, CFDs and options on a commodity index

- 13 R *Commodity index futures* and *commodity index options* (unless the *option* is included in the *firm's option PRR* calculation), must be treated as follows:
- (1) Step 1: The total quantity underlying the contract must be either:
 - (a) treated as a single notional *commodity* position (separate from all other *commodities*); or
 - (b) divided into notional positions, one for each of the constituent *commodities* in the index, of an amount which is a proportionate part of the total underlying the contract according to the weighting of the relevant *commodity* in the index.
 - (2) Step 2: Each notional position determined in step 1 must then be included:
 - (a) when using the simplified approach (24R), without adjustment; or
 - (b) when using the maturity ladder (25R) or modified maturity ladder approach (30R), with the adjustments in table 32R.
- 14 R Table: Treatment of *commodity index futures* and *commodity index options* (see 13R(2)(b)).

Construction of index	Notional position (or positions) and maturity
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Spot level of index is based on the spot price of each constituent <i>commodity</i>	Each quantity determined in step 1 is assigned a maturity equal to the expiry date of the contract.
Spot level of index is based on an average of the forward prices of each constituent <i>commodity</i>	Each quantity determined in step 1 is divided (on a pro-rata basis) into a series of forward positions to reflect the impact of each forward price on the level of the index. The maturity of each forward position equals the maturity of the relevant forward price determining the level of the index when the contract expires.

- 15 G An example of using 13R and table 14R is as follows. A *firm* is long a three-month *commodity index future* where the spot level of the index is based on the one, two and three month forward prices of aluminium, copper, tin, lead, zinc and nickel (18 prices in total).

Step 1: the *firm* must decide whether to treat the full quantity underlying the contract as a single notional *commodity* position, or disaggregate it into notional positions in aluminium, copper, tin, lead, zinc and nickel. In this case the firm decides to disaggregate the contract into notional positions in aluminium, copper, tin, lead, zinc and nickel.

Step 2: if the *firm* uses the simplified method, nothing more need be done to arrive at the notional position. In this case the *firm* uses the maturity ladder approach and so subdivides each position in each metal into three because the level of the index is based on the prevailing one, two and three month forward prices. Since the *future* will be settled in three months' time at the prevailing level of the index, the three positions for each metal will have maturities of four, five and six months respectively.

Commodity swaps

- 16 R A *firm* must treat a *commodity swap* as a series of notional positions, one position for each payment under the *swap*, each of which:
- (1) equals the total quantity underlying the contract;
 - (2) has a maturity corresponding to the payment date; and
 - (3) is long or short according to 17R.
- 17 R Table: Treatment of *commodity swaps* (see 16R)

	Receiving amounts which are unrelated to any <i>commodity's</i> price	Receiving the price of <i>commodity 'b'</i>
Paying amounts which are unrelated to any <i>commodity's</i> price	N/A	Long positions in <i>commodity 'b'</i>

Paying the price of <i>commodity</i> 'a'	Short positions in <i>commodity</i> 'a'	Short positions in <i>commodity</i> 'a' and long positions in <i>commodity</i> 'b'
18	G	Table 17R shows that where the legs of the swap are in different commodities, a series of forward positions are created for each commodity (that is, a series of short positions in commodity 'a' and a series of long positions in commodity 'b').
19	G	Table 17R also covers the case where one leg is unrelated to any commodity's price. This leg may be subject to a PRR under another appendix; for example, an interest rate based leg would have to be included in a firm's interest rate PRR calculation.

Calculating the PRR for each commodity

- 20 R A *firm* must calculate a *PRR* for each *commodity* separately using either the simplified approach (24R), the maturity ladder approach (25R) or the modified maturity ladder approach (30R).
- 21 G A *firm* need not use the same approach for all *commodities*.
- 22 R A *firm* must treat positions in different grades or brands of the same *commodity*-class as different *commodities* unless they:
- (1) can be delivered against each other; or
 - (2) have price movements which have exhibited a stable correlation coefficient of at least 0.9 over the last 12 months. The *firm* must then monitor the correlation on a continuing basis
- 23 R If a *firm* intends to rely on the approach in 22R(2) it must:
- (1) notify the *FSA* in writing at least twenty *business days* prior to the date the *firm* starts relying on it.
 - (2) when it notifies the *FSA* under (1) the *firm* must also provide to the *FSA* the analysis of price movements on which it relies.

SIMPLIFIED APPROACH

- 24 R A *firm* which calculates PRR using the simplified approach must do so by summing:
- (1) 15% of the net position multiplied by the spot price for the *commodity*; and
 - (2) 3% of the gross position (long plus short, ignoring the sign) multiplied by the spot price for the *commodity*.

Maturity ladder approach

- 25 R A *firm* using the maturity ladder approach must calculate the *PRR* following the steps in 26R and then sum all spread charges, carry charges and outright charges that result.
- 26 R The *firm* must calculate the charges referred to in 25R as follows:
- (1) Step 1: Offset long and short positions maturing:
 - (a) on the same day; or
 - (b) (in the case of positions arising under contracts traded in markets with daily delivery dates) within 10 *business days* of each other.
 - (2) Step 2: Allocate the positions remaining after step 1 to the appropriate maturity band in table 28R (*physical commodity* positions are allocated to band 1).
 - (3) Step 3: Match long and short positions within each band. In each instance, calculate a spread charge equal to the matched amount multiplied first by the spot price for the *commodity* and then by the spread rate of 3%.
 - (4) Step 4: Carry unmatched positions remaining after step 3 to another band where they can be matched, then match them. Do this until all matching possibilities are exhausted. In each instance, calculate:
 - (a) a carry charge equal to the carried position multiplied by the spot price for the *commodity*, the carry rate of 0.6% and the number of bands by which the position is carried; and
 - (b) a spread charge equal to the matched amount multiplied by the spot price for the *commodity* and the spread rate of 3%.
 - (5) Step 5: Calculate the outright charge on the remaining positions (which will either be all long positions or all short positions). The outright charge equals the remaining position (ignoring the sign) multiplied by the spot price for the *commodity* and the outright rate of 15%.
- 27 G The matched amount in 26R is the lesser (ignoring the sign) of either the total long position or the total short position. For example, a band with 1000 long and 700 short results in a matched amount of 700. The unmatched amount would be 300.
- 28 R Table: Maturity bands for the maturity ladder approach (see 26R))

Band	Maturity of position
Band 1	$0 \leq 1$ month
Band 2	> 1 month ≤ 3 months
Band 3	> 3 months ≤ 6 months
Band 4	> 6 months ≤ 1 year
Band 5	> 1 year ≤ 2 years
Band 6	> 2 years ≤ 3 years
Band 7	> 3 years

- 29 G Figure: An example illustrating the calculation of the *PRR* on an individual *commodity* using the maturity ladder approach (26R).

Figure 29G: After a *firm* has carried out the pre-processing required by 26R(1) (that is, step 1), it follows steps 2 to 5 as shown below. Because the *firm* is using the maturity ladder approach the spread rate is 3%, the carry rate is 0.6% and the outright rate is 15%. The example assumes that the spot price for the *commodity* is £25.

Band	Step 2	Step 3	Step 4a	Step 4b	Step 6																				
	Allocate remaining positions to appropriate maturity bands	Match within bands. Each matched amount incurs a spread charge.	Carry across bands. Each carried amount incurs a carry charge.	Match within band. Each matched amount incurs a spread charge.	Remaining position(s) incur an outright charge.																				
$0 \leq 1$ month			300 carried																						
>1 month ≤ 3 months	1000 long 700 short	700 matched																							
>3 months ≤ 6 months																									
>6 months ≤ 1 year			100 carried																						
>1 year ≤ 2 years	600 short	Nothing matched		400 matched	200 short remains																				
>2 years ≤ 3 years																									
> 3 years	100 long	Nothing matched																							
<table style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 20%;">Spread charges</td> <td style="width: 30%;">$700 * \text{£}25 * 3\% + 400 * \text{£}25 * 3\%$</td> <td style="width: 10%; text-align: right;">=</td> <td style="width: 10%; text-align: right;">£825</td> <td style="width: 20%;"></td> </tr> <tr> <td>Carry charges</td> <td>$300 * \text{£}25 * 0.6\% * 3 + 100 * \text{£}25 * 0.6\% * 2$</td> <td style="text-align: right;">=</td> <td style="text-align: right;">£165</td> <td></td> </tr> <tr> <td>Outright charge</td> <td>$200 * \text{£}25 * 15\%$</td> <td style="text-align: right;">=</td> <td style="text-align: right;">£750</td> <td></td> </tr> <tr> <td colspan="3"></td> <td style="text-align: right; border-top: 1px solid black; border-bottom: 3px double black;">£1740</td> <td></td> </tr> </table>						Spread charges	$700 * \text{£}25 * 3\% + 400 * \text{£}25 * 3\%$	=	£825		Carry charges	$300 * \text{£}25 * 0.6\% * 3 + 100 * \text{£}25 * 0.6\% * 2$	=	£165		Outright charge	$200 * \text{£}25 * 15\%$	=	£750					£1740	
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Outright charge	$200 * \text{£}25 * 15\%$	=	£750																						
			£1740																						

Modified maturity ladder approach

- 30 R Until 31 December 2006 a *firm* may use the modified maturity ladder approach to calculate the *PRR* for a particular *commodity* provided the *firm*:

- (1) has a diversified *commodities* portfolio;
- (2) undertakes significant *commodities* business; and
- (3) notifies the *FSA* in writing:
 - (a) at least twenty *business days* before the date the *firm* intends to start using the modified maturity method; and
 - (b) If the facts and matters relied on to demonstrate that the *firm* meets the criteria in (1) and (2).

31 R A *firm* using the modified maturity ladder approach must calculate the *PRR* by:

- (1) following the same steps as in 26R but using the rates from table 32R rather than those in 26R; and
- (2) summing all spread charges, carry charges and outright charge that result.

32 R Table: Alternative spread, carry and outright rates (see 31R).

	Precious metals (excluding gold)	Base metals	Softs (agricultural)	Other (including energy)
Spread rate (%)	2	2.4	3	3
Carry rate (%)	0.3	0.5	0.6	0.6
Outright rate (%)	8	10	12	15

33 G For the purposes of 30R(1) a *firm* has a diversified *commodity* portfolio where it holds positions in more than one of the *commodities* falling in any of the categories set out in table 32R and holds positions across different maturities in those individual *commodities*. A *firm* would not have a diversified *commodity* portfolio if it held positions in only one *commodity* in each of the categories set out in table 32R. This is because the rates in table 32R assume *firms* have positions in more than one of that category's *commodities*. Different *commodities* within a given category are likely to exhibit different volatilities, so where a *firm* does not have a diversified *commodity* portfolio in that category, the rates applying to that category might underestimate the regulatory capital required for a certain *commodity* at certain times.

34 G What constitutes significant business in 30R(2) will vary from *firm* to *firm*. The more regularly the *firm* undertakes trades in *commodities* and the more consistently it has positions in the relevant *commodity*, the more likely it is to be undertaking significant business for the purposes of 30R(2).

35 R Where a *firm* is:

- (1) treating a *commodity* index derivative as if it was based on a single separate *commodity* (see 13R(1)(a)); and

- (2) uses the modified maturity ladder approach to calculate the *PRR* for that *commodity*;

it must determine which index constituent incurs the highest rate in table 32R and apply that rate to the notional position for the purposes of 31R.

- 36 G Where an index is only based on precious metals, 13R allows the *firm* to treat the single notional position as precious metal for the purposes of 31R. However, if the index contained a mix of precious metals and base metals the *firm* would have to treat the notional position under 35R as a base metal (because base metals attract a higher rate than precious metals in table 32R).

Appendix 7

Securities Underwriting

General rules

- 1 G This appendix sets out the method for calculating a net *underwriting* position or reduced net *underwriting* position, which is then included in the *PRR* calculation in other appendices, or the liquidity adjustment calculation.
- 2 R A *firm* which *underwrites* or sub-*underwrites* an issue of *securities* must:
 - (1) identify commitments to *underwrite* or sub-*underwrite* which give rise to an *underwriting* position (see 8R);
 - (2) identify the time of initial commitment (see 14R);
 - (3) calculate the net *underwriting* position (set out in 18R) or reduced net *underwriting* position (if permitted under 24R);
- 3 R A *firm* must include the net *underwriting* position or reduced net *underwriting* position in:
 - (1) 3R(1) of appendix 4, where debt *securities* are being underwritten;
 - (2) 2R(1) of appendix 5, where *equities* are being underwritten;
 - (3) 22R of appendix 9, where *warrants* are being underwritten; or
 - (4) 10-66(1)R where the *firm* does not have a *trading book*; and
 - (5) 2R of appendix 8, where the *equities*, debt *securities* or *warrants* being underwritten are denominated in a *foreign currency*.
- 4 R A *firm* must comply with 2R from initial commitment (as determined under 8R) until the end of the fifth *business day* after *working day 0* (as determined under 23R).
- 5 G Sub-*underwriting* is a commitment given by one *firm* to someone other than the issuer or seller of the *securities*, to *underwrite* all or part of an issue of *securities*.
- 6 G The net *underwriting* position calculated in 18R will also be used in calculating the net *underwriting exposure* set out in 32R.
- 7 G The net *underwriting* position or reduced net *underwriting* position arising from *underwriting* or sub-*underwriting* a rights or *warrants* issue should be calculated using the current market price of the underlying *security* for the purposes of the *equity PRR* or *option PRR*. However, the *PRR* will be limited to the value of the net *underwriting* position calculated using the initial issue price of the rights or *warrants*.

Commitments to underwrite securities

- 8 R For the purpose of 2R(1), a *firm* has a commitment to *underwrite* or sub-*underwrite* an issue of *securities* where:
- (1) it gives a commitment to an issuer of *securities* to *underwrite* an issue of *securities*;
 - (2) it gives a commitment to a person, other than the issuer of *securities*, to sub-*underwrite* an issue of *securities*; or
 - (3) it is a member of a syndicate or group that gives a commitment to an issuer to *underwrite* an issue of *securities* or a commitment to a person other than the issuer of *securities*, to sub-*underwrite* an issue of *securities*.
- 9 G Block trades including bought deals, private placements, revolving *underwriting* facilities and *underwriting* syndicated loans are not within the scope of this appendix.
- 10 R For the purpose of this appendix, *securities* include debt and *equity instruments*, and *instruments* which are convertible into *securities* but excludes loans.
- 11 R A *firm* that buys and sells *securities* before issue is dealing in the grey market. This appendix does not apply to a *firm* dealing in the grey market unless the *firm*:
- (1) has an *underwriting* commitment to the issuer in respect of those *securities*; or
 - (2) has a sub-*underwriting* commitment in respect of those *securities* and is using the grey market solely for the purpose of reducing that sub-*underwriting* commitment.
- 12 G In this appendix the grey market is the market in which dealers "buy" and "sell" *securities* ahead of issue. In reality the dealers are buying and selling promises to deliver the *securities* when issued.
- 13 R Where a single *firm* is involved in both *underwriting* or sub-*underwriting* an issue of *securities* as well as dealing in that issue for proprietary trading purposes this appendix will not apply to grey market transactions undertaken by the proprietary trading part of the *firm*.

Time of initial commitment

- 14 R Subject to 15R, the time of initial commitment is the earlier of:
- (1) the time the *firm* signs an agreement with the issuer of *securities* to *underwrite* those *securities*; or
 - (2) the time the price and allocation of the issue are set.
- 15 R If a *firm* has an irrevocable and unfettered right to withdraw from an *underwriting* commitment, exercisable within a certain period, the commitment commences when that right expires.
- 16 G Subject to the existence of a right described in 15R an *underwriting* commitment commences even if it is subject to formal, legal or other conditions that would normally be expected to be satisfied.

- 17 G A force majeure or material adverse change clause would not be a right of the sort referred to in 15R.

Calculating the net underwriting position

- 18 R A *firm* must calculate a net *underwriting* position by adjusting the gross amount it has committed to *underwrite* for:
- (1) any sales or sub-*underwriting* commitments received that have been confirmed in writing at the time of initial commitment;
 - (2) any *underwriting* or sub-*underwriting* commitments obtained from others since the time of initial commitment;
 - (3) any purchases or sales of the *securities* since the time of initial commitment, (other than those referred to in 13R); and
 - (4) any allocation of *securities* granted or received, arising from the commitment to *underwrite* the *securities*, since the time of initial commitment.
- 19 R A *firm* signing an *underwriting* agreement with an issuer of *securities* where the exact issue price or allocation of *securities* has not been fixed must calculate the gross amount, for the purposes of 18R, as the amount it has formally committed to under that agreement until the time the exact issue price and/or allocation is set.
- 20 G Allocations may arise, after date of initial commitment, from the agreement to *underwrite*. For example obligations or rights to or from the issuer, the *underwriting* group or syndicate.

GREY MARKET TRANSACTIONS

- 21 R Subject to 11R and 13R a *firm* may include grey market transactions when calculating the net *underwriting* position.

OVER-ALLOTMENT OPTIONS

- 22 R When calculating the net *underwriting* position, a *firm* must exclude an over-allotment option granted to it by the issuer, except to the extent it reduces:
- (1) from working day 0 an over-allotment made by the *firm*; or
 - (2) from working day 0 an over-allotment made by the *firm* on behalf of another member of the *underwriting* syndicate who has been granted the over-allotment option.
- 23 R For the purposes of this appendix ‘working day 0’ is the *business day* on which the *firm* becomes unconditionally committed to accepting a known quantity of *securities* at a specified price, as follows:

- (1) For debt issues and *securities* which are issued in a similar manner, ‘working day 0’ is the later of the date on which the *securities* are allotted, and the date on which payment for them is due.
- (2) For *equity* issues and *securities* which are issued in a similar manner, ‘working day 0’ is the later of the date on which the offer becomes closed for subscriptions and the date on which the allocations are made public.
- (3) For rights issues, ‘working day 0’ is first day after the date on which the offer becomes closed to acceptances for subscription.

Calculating the reduced net underwriting position

- 24 R A *firm* may apply the relevant reduction factors in table 27R to its net *underwriting* position if the *securities* it is *underwriting* or *sub-underwriting* are new *securities*.
- 25 R For the purposes of this appendix, a *firm* may treat as new *securities*:
- (1) *securities* that have not previously been offered for sale or subscription by an issuer; or
 - (2) *securities* that have not previously been traded on a *recognised investment exchange, designated investment exchange* or a *regulated market*.
- 26 R To calculate the reduced net *underwriting* position a *firm* must apply table 27R to the net *underwriting* position (calculated under 18R) as follows:
- (1) In respect of debt *securities*, a *firm* must calculate two reduced net *underwriting* positions; one for inclusion in the *firm*’s specific risk calculation (43R of appendix 4), the other for inclusion in its general market risk calculation (48R of appendix 4).
 - (2) In respect of *equities*, a *firm* must calculate only one reduced net *underwriting* position, and then include it in the simplified equity method (see 27R of appendix 5).
- 27 R Table: Net *underwriting* position reduction factors (see 26R)

<i>Underwriting timeline</i>	Debt		Equity
	General market risk	Specific risk	
Time of initial commitment until <i>working day 0</i>	0%	100%	90%
Working day 1	0%	90%	90%
Working day 2	0%	75%	75%
Working day 3	0%	75%	75%

Working day 4	0%	50%	50%
Working day 5	0%	25%	25%
Working day 6 and onwards	0%	0%	0%

- 28 G Figure: An example of the reduced net *underwriting* position calculation. The example is based on the *firm* starting with a commitment to underwrite £100 million of a new *equity* issue.

Time	Net <i>underwriting</i> position (see 18R)	Percentage reduction (see 27R)	Reduced net <i>underwriting</i> position ¹
At initial commitment 9.00am Monday	£100m gross amount is reduced by £20m due to sales/ sub- <i>underwriting</i> commitments confirmed in writing at the time of initial commitment (see 18R(1)). = £80m	90%	£8m
Post initial commitment 9.02am Monday	Remaining £80m is reduced by £40m due to further sales, sub- <i>underwriting</i> commitments obtained and allocations granted (see 18R (2) – (4)). = £40m	90%	£4m
At the end of working day 1	Remaining £40m is reduced to £20m due to further sales. = £20m	90%	£2m
End of working day 3	Remaining £20m is reduced to £5m due to further sales. = £5m	75%	£1.25 m
End of working day 4	Remaining £5m is reduced to £2m due to further sales. = £2m	50%	£1m
End of working day 5	Remaining £2m is reduced to £1m due to further sales. = £1m	25%	£0.75 m
Start of working day 6	£1m remaining = £1m	0%	£1m

Note: ¹ *Firms* are reminded that in the case of an *equity*, the reduced net *underwriting* position must be treated under the simplified equity method (see 27R of appendix 5)

Large exposure risk from underwriting securities

CALCULATING THE NET UNDERWRITING EXPOSURE

- 29 R For the purposes of calculating the *LER* set out in 10-194R a *firm* must include net *underwriting exposures* to an issuer in the calculation of its total *exposure* to that issuer.
- 30 R A *firm* must include counterparty exposures to any sub-underwriters for the purposes of calculating the *LER* set out in 10-194R.
- 31 R A *firm*, before entering into a new *underwriting* commitment must be able to recalculate *LER* to the level of detail necessary to ensure that the *firm's financial resources requirement* does not exceed the *firm's financial resources*.

32 R A *firm* must calculate the net *underwriting exposure* to an issuer by applying the relevant reduction factors in table 33R to its net *underwriting* position calculated under 18R.

33 R Table: Calculation of net *underwriting exposure* (see 32R)

Time	Reduction factor to be applied to net <i>underwriting</i> position
Initial commitment to <i>working day 0</i>	100%
<i>Working day 0</i>	100%
Working day 1	90%
Working day 2	75%
Working day 3	75%
Working day 4	50%
Working day 5	25%
Working day 6 onwards	0%

34 R There is no *large exposure* limit or *LER* for net *underwriting exposures* between initial commitment and working day 0, except where specified by a requirement on a *firm's Part IV permission*. The *large exposure* requirements are set out in 10-190 to 10-196.

MONITORING AND REPORTING LARGE EXPOSURES

35 R For the purposes of *large exposures* monitoring only, a *firm* must report its net *underwriting exposure* from the date of initial commitment rather than working day 0.

Risk management

36 R A *firm* must take reasonable steps to establish and maintain such systems and controls to monitor and manage its *underwriting* and sub-*underwriting* business as are appropriate to the nature, scale and complexity of its *underwriting* and sub-*underwriting* business.

37 G The general requirements for systems and controls are set out in SYSC. 36G is specific to a *firm's underwriting* and sub-*underwriting* business.

38 G A *firm* must take reasonable steps to:

- (1) allocate responsibility for the management of its *underwriting* and sub-*underwriting* business;
- (2) allocate adequate resources to monitor and control its *underwriting* and sub-*underwriting* business;

- (3) satisfy itself that its systems to monitor *exposure* to counterparties will calculate, revise and update its *exposure* to each counterparty arising from its *underwriting* or sub-*underwriting* business;
- (4) satisfy itself of the suitability of each person who performs functions for it in connection with the *firm's underwriting* business having regard for the person's skill and experience; and
- (5) satisfy itself that its procedures and controls to monitor and manage its *underwriting* business address, on an on-going basis, the capacity of sub-*underwriters* to meet sub-*underwriting* commitments.

Appendix 8

Foreign exchange PRR

General rule

- 1 R A *firm* must calculate its foreign exchange *PRR* by:
- (1) identifying which *foreign currency* and gold positions to include in the *PRR* calculation;
 - (2) calculating the *open currency position* and net gold position; and
 - (3) multiplying the sum (ignoring the sign) of the *open currency position* and the net gold position by 8%.
- G For example, a *firm* has an *open currency position* of -£100 and a net gold position of £50. The sum (ignoring the sign) is £150, and so the foreign exchange *PRR* is £12.

Scope of the foreign exchange PRR calculation

- 2 R A *firm*'s foreign exchange *PRR* calculation must include the following items regardless of whether they are *trading book* or *non-trading book* positions:
- (1) all gold positions;
 - (2) all instruments which are denominated in a *foreign currency*, except:
 - (a) *foreign currency* assets which have been deducted in full from the *firm*'s *financial resources*;
 - (b) instruments hedging (a);
 - (c) instruments hedging the *firm*'s capital; or
 - (d) instruments hedging a future *foreign currency* income or expense which is known but not yet accrued; and
 - (3) notional positions arising from the instruments listed in table 4R:
- 3 R A *firm* must notify the *FSA* in writing if it uses the exclusions under 2R(2)(a)-(d).

4 R Table: instruments which result in notional *foreign currency* positions (see 2R(3)).

Foreign exchange <i>futures, forwards, synthetic futures</i> and <i>CFDs</i>	10R
Foreign exchange <i>swaps</i>	12R
Foreign exchange <i>options</i> or <i>warrants</i> (unless the <i>firm</i> calculates a <i>PRR</i> on the <i>option</i> or <i>warrant</i> under appendix 9).	14R
Gold <i>futures, forwards, synthetic futures</i> and <i>CFDs</i>	15R
Gold <i>options</i> (unless the <i>firm</i> calculates a <i>PRR</i> on the <i>option</i> under appendix 9).	16R

5 G *Firms* are reminded that table 5R in appendix 9 divides foreign exchange *options* and *warrants* into:

- (1) those which must be treated under appendix 9; and
- (2) those which must be treated under either appendix 8 or appendix 9, but *firms* can choose whether appendix 8 or 9 is used.

6 R When determining the currency of denomination *firms* must:

- (1) use the currency in which the *firm* accounts for the instrument where an instrument is quoted in more than one currency; and
- (2) treat depository receipts as positions in the underlying security.

7 G Instruments denominated in a foreign currency include, amongst other things, assets and liabilities (including accrued interest); non-foreign exchange *derivatives*; net *underwriting* positions; reduced net *underwriting* positions; and irrevocable guarantees (or similar instruments) that are certain to be called.

8 G Where a contract is based on a basket of currencies, the *firm* can choose either to derive notional positions in each of constituent currencies, or treat it as a single notional position in a separate hypothetical currency.

Derivation of notional positions

9 G This section derives notional currency positions for the instruments listed in table 4R.

FOREIGN EXCHANGE FORWARDS, FUTURES, CFDs AND SYNTHETIC FUTURES

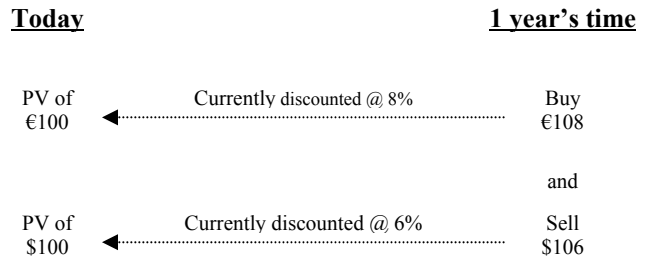
10 R A *firm* must treat a foreign exchange *forward, future* or *CFD* as two notional currency positions as follows:

- (1) a long notional position in the currency which the *firm* has contracted to buy; and
- (2) a short notional position in the currency which the *firm* has contracted to sell;

where the notional positions have a value equal to either:

- (a) the contracted amount of each currency to be exchanged in the case of a *forward* or *future* held in the *non-trading book*; or
- (b) the present value of the amount of each currency to be exchanged in the case of a *forward* or *future* held in the *trading book*.

- 11 G For example, a *firm* contracts to sell \$106 for €108 in one year's time.
The present values of each cash flow are \$100 and €100 respectively.



- In the *non-trading book*, this *forward* would be treated as a combination of a €108 long position and a \$106 short position.
- In the *trading book*, this *forward* would be treated as a combination of a €100 long position and a \$100 short position.

Firms are reminded that foreign exchange *forwards* held in the *trading book* must also be included in the *firm's* interest rate *PRR* calculation (see 4R of appendix 4).

FOREIGN EXCHANGE SWAPS

- 12 R A *firm* must treat an foreign exchange *swap* as:
- (1) a long notional position in the currency which the *firm* has contracted to receive interest and principal;
 - (2) a short notional position in the currency which the *firm* has contracted to pay interest and principal; and
 - (3) where the notional positions have a value equal to either:
 - (a) the nominal amount of each currency underlying the *swap* if it is held in the *non-trading book*; or
 - (b) the present value amount of all cash flows in the relevant currency in the case of a *swap* held in the *trading book*.
- 13 G For example, a *firm* enters into a five year foreign exchange *swap* where it contracts to pay six month US\$ Libor on \$100 in return for receiving 6% fixed on €100. The present values of each leg are \$100 and €98 respectively.

- In the *non-trading book*, this *swap* would be treated as a combination of a €100 long position and a \$100 short position.
- In the *trading book*, this *swap* would be treated as a combination of a €98 long position and a \$100 short position.

Firms are reminded that foreign exchange *swaps* held in the *trading book* must also be included in the *firm's* interest rate *PRR* calculation (see table 4R of appendix 4).

FOREIGN EXCHANGE OPTIONS AND WARRANTS

- 14 R Where included in this appendix's *PRR* calculation (see table 4R), a foreign exchange *option* or *warrant* must be treated as a foreign exchange *forward*.

GOLD FORWARDS, FUTURES AND CFDS

- 15 R A *forward*, *future* or *CFD* on gold must be treated as a notional position in gold with a value equal to the amount of gold underlying multiplied by the current spot price for gold.

GOLD OPTIONS

- 16 R If included in the *PRR* calculation under this appendix (see table 4R), a gold *option* must be treated as a gold *forward*.

Open currency position

- 17 R A *firm* must calculate its *open currency position* by:
- (2) calculating the net position in each *foreign currency*;
 - (3) converting each net position into its *base currency* equivalent at current spot rates;
 - (4) summing all short net positions and summing all long net positions; and
 - (5) selecting the larger sum (ignoring the sign) from (3).

Net gold position

- 18 R A *firm* must calculate its net gold position by:
- (1) valuing all gold positions using the prevailing spot price for gold (regardless of the maturity of the positions);
 - (2) offsetting long and short positions; and
 - (3) converting the resulting net position into the *base currency* equivalent using the current spot foreign exchange rate.

Appendix 9

Option PRR

Option PRR calculation

- 1 R A *firm* must calculate its *option PRR* by:
 - (1) identifying which *option* positions must be included within the scope of the *option PRR* calculation under 3R to 5R;
 - (2) calculating the derived position in each *option* in accordance with 9R to 15R;
 - (3) calculating the *PRR* for each derived position in accordance with 16R to 32G;
 - (4) summing all of the *PRRs* calculated in accordance with (3).
- 2 G *Firms* are reminded that table 4R of appendix 4 and table 3R of appendix 5 also require an interest rate *PRR* to be calculated for *options* on *equities*, baskets of *equities* or *equity* indices. The interaction between this appendix and others is illustrated in 33G.

Scope of the option PRR calculation

- 3 R Except as permitted under 5R, a *firm's option PRR* calculation must include:
 - (1) each *trading book* position in an *option* on an *equity*, interest rate or debt *security*;
 - (2) each *trading book* position in a *warrant* on an *equity* or debt *security*; and
 - (3) each *trading book* and *non-trading book* position in an *option* on a *commodity*, currency or gold.
- 4 G 3R(2) includes net *underwriting* positions or reduced net *underwriting* positions in *warrants*.

5 R Table: Appropriate *PRR* calculation for an *option* or warrant (see 3R)

<i>Option type (see 18R) or Warrant</i>	<i>PRR calculation</i>
American <i>option</i> , European <i>option</i> , Bermudan <i>option</i> , Asian <i>option</i> or <i>warrant</i> for which the <i>in the money</i> percentage (see 6R) is equal to or greater than the appropriate <i>PRA</i> (see 7R and 8R)	Calculate either an <i>option PRR</i> , or the most appropriate to the underlying position of: (a) an <i>equity PRR</i> (b) an interest rate <i>PRR</i> (c) a <i>commodity PRR</i> (d) a foreign exchange <i>PRR</i>
American <i>option</i> , European <i>option</i> , Bermudan <i>option</i> , Asian <i>option</i> or <i>warrant</i> : (a) for which the <i>in the money</i> percentage (see 6R) is less than the appropriate <i>PRA</i> (see 7R and 8R); or (b) that is <i>at the money</i> ; or (c) that is <i>out of the money</i> .	Calculate an <i>option PRR</i>
All other types of <i>option</i> listed in 18R (regardless of whether <i>in the money</i> , <i>at the money</i> or <i>out of the money</i>).	

THE IN THE MONEY PERCENTAGE

6 R The *in the money* percentage is calculated as follows:

For a call *option*:

$$\frac{\text{Current market price of the underlying} - \text{Strike price of the option}}{\text{Strike price of the option}} * 100$$

For a put *option*:

$$\frac{\text{Strike price of the option} - \text{Current market price of the underlying}}{\text{Strike price of the option}} * 100$$

THE APPROPRIATE *PRA*

7 R The appropriate *PRA* for a position is that listed in table 8R against the relevant underlying position.

8 R Table: Appropriate *PRA* (see 7R)

Underlying Position	Appropriate PRA
<i>Equity</i>	The <i>PRA</i> applicable to the underlying <i>equity</i> or <i>equity</i> index in table 30R of Appendix 5 (simplified equity method)
Interest rate	The sum of the specific risk <i>PRA</i> (table 44R of appendix 4) and the general market risk <i>PRA</i> (53R of appendix 4) applicable to the underlying position
Debt <i>securities</i>	The sum of the specific risk <i>PRA</i> (table 43R of appendix 4) and the general market risk <i>PRA</i> (table 52R of appendix 4) applicable to the underlying position
<i>Commodity</i>	15% (unless the <i>firm</i> uses the modified maturity ladder approach in which case it is the outright rate applicable to the underlying position; see 30R-32R of appendix 6)
Currency	8%
Gold	8%

Calculating derived positions

- 9 R A *firm* must calculate the derived position specified in the table in 13R for each position included in its *option PRR* calculation.

NETTING POSITIONS

- 10 R A *firm* may calculate a derived position for its net position in an *option* or a *warrant*, if the relevant *options* or *warrants* are identical or may be treated as identical under 11R or 12R.
- 11 R A *firm* may treat *options* or *warrants* as identical if they have the same strike price, maturity (except for an interest rate cap or floor – see 12R) and underlying.
- 12 R A *firm* may treat as identical a purchased interest rate cap (or floor) and a written interest rate cap (or floor) only if they mature within 30 days of each other and all other terms are identical (a cap may not be netted against a floor).

DERIVED POSITIONS

- 13 R Table: Derived positions (see 9R)

	<i>Option (or warrant)</i>	Derived position
<i>Equity</i>	<i>Option (warrant)</i> on a single <i>equity</i> or <i>option</i> on a <i>future/forward</i> on a single <i>equity</i>	A notional position in the actual <i>equity</i> underlying the contract valued at the current market price of the <i>equity</i> .

	<i>Option (warrant) on a basket of equities or option on a future/forward on a basket of equities</i>	A notional position in the actual <i>equities</i> underlying the contract valued at the current market price of the <i>equities</i> .
	<i>Option (warrant) on an equity index or option on a future/forward on an equity index</i>	A notional position in the index underlying the contract valued at the current market price of the index.
Interest rate	<i>Option on an interest rate or an interest rate future/FRA</i>	A zero coupon <i>zero-specific-risk security</i> in the currency concerned with a maturity equal to the sum of the time to expiry of the contract and the length of the period on which the settlement amount of the contract is calculated valued at the notional amount of the contract.
	<i>Option on an interest rate swap</i>	A zero coupon <i>zero-specific-risk security</i> in the currency concerned with a maturity equal to the length of the <i>swap</i> valued at the notional principal amount.
	Interest rate cap or floor	A zero coupon <i>zero-specific-risk security</i> in the currency concerned with a maturity equal to the remaining period of the cap or floor valued at the notional amount of the contract.
Debt securities	<i>Option (warrant) on a debt security or option on a future/forward on a debt security</i>	The underlying debt <i>security</i> with a maturity equal to the time to expiry of the <i>option</i> valued as the nominal amount underlying the contract at the current market price of the debt <i>security</i> .
Commodity	<i>Option on a commodity or option on a future/forward on a commodity</i>	An amount equal to the tonnage, barrels or kilos underlying the <i>option</i> with a maturity equal to the expiry date of the <i>forward</i> or <i>futures</i> contract underlying the <i>option</i> .
Gold	<i>Option on gold or option on a future/forward on gold</i>	An amount equal to the troy ounces underlying the <i>option</i> with a maturity equal to the expiry date of the <i>forward</i> or <i>futures</i> contract underlying the <i>option</i> .

Currency	Currency <i>option</i>	The amount of the underlying currency that the <i>firm</i> will receive if the <i>option</i> is exercised converted at the spot rate into the currency that the <i>firm</i> will sell if the <i>option</i> is exercised.
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Combinations of options which can be treated as one option

- 14 R** A *firm* may treat (for the purpose of calculating an *option PRR* under this appendix) an *option* strategy listed in table 15R as the single position in a notional *option* specified against that strategy in table 15R, if:
- (1) each element of the strategy is transacted with the same *counterparty*;
 - (2) the strategy is documented as a single structure;
 - (3) each *option* in the structure has the same maturity and underlying; and
 - (4) the constituent parts of the structure form an indivisible single contract, so that neither party can unwind or default on one part of the structure without doing so for the contract as a whole.

15 R Table: *Option strategies* (see 14R)

<i>Option strategy</i> (and an example)	<i>Notional option position</i> (and rule it must be treated under)
Bull Spread (e.g. buy 100 call and sell 101 call)	One purchased <i>option</i> (treat under 20R)
Bear Spread (e.g. sell 100 put and buy 101 put)	One written <i>option</i> (treat under 21R)
Synthetic Long Call (e.g. long underlying and buy 100 put)	One purchased <i>option</i> (treat under 20R or 24R)
Synthetic Short Call (e.g. short underlying and sell 100 put)	One written <i>option</i> (treat under 21R or 24R)
Synthetic Long Put (e.g. short underlying and buy 100 call)	One purchased <i>option</i> (treat under 20R or 24R)
Synthetic Short Put (e.g. buy underlying and sell 100 call)	One written <i>option</i> (treat under 21R or 24R)
Long Straddle (e.g. buy 100 call and buy 100 put)	One purchased <i>option</i> (treat under 20R)
Short Straddle (e.g. sell 100 call and sell 100 put)	One written <i>option</i> (treat under 21R but with no reduction for the amount the <i>option</i> is <i>out of the money</i>)
Long Strangle (e.g. buy 101 call and buy 99 put)	One purchased <i>option</i> (treat under 20R)
Short Strangle (e.g. sell 99 call and sell 101 put)	One written <i>option</i> (treat under 21R but with no reduction for the amount the <i>option</i> is <i>out of the money</i>)
Long Butterfly (e.g. buy one 100 call, sell two 101 calls, and buy one 102 call)	One purchased <i>option</i> (treat under 20R)
Short Butterfly (e.g. sell one 100 put, buy two 101 puts, and sell one 102 put)	One written <i>option</i> (treat under 21R but with no reduction for the amount the <i>option</i> is <i>out of the money</i>)

The option PRR for an individual position

- 16 R A *firm* must calculate the *PRR* for each individual derived *option* position using the method specified in table 18R, or, if more than one method is permitted, using one of those methods.
- 17 R The resulting *PRRs* must be converted to the *firm's base currency* using spot foreign exchange rates.
- 18 R Table: *Option PRR* methods for different types of *option* (see 16R)

Option	Description	Method
American <i>option</i>	An <i>option</i> that may be exercised at any time over an extended period up to its expiry date.	Standard method or hedging method if appropriate
European <i>option</i>	An <i>option</i> that can only be exercised at expiry.	
Bermudan <i>option</i>	A cross between an American <i>option</i> and European <i>option</i> . The Bermudan <i>option</i> can only be exercised at specific dates during its life.	
Asian <i>option</i>	The buyer has the right to exercise at the average rate or price of the underlying over the period (or part of the period) of the <i>option</i> . One variant is where the payout is based on the average of the underlying against a fixed strike price; another variant is where the payout gives at expiry the price of the underlying against the average price over the <i>option</i> period.	
Barrier <i>option</i>	An <i>option</i> which is either cancelled or activated if the price of the underlying reaches a pre-set level regardless of the price at which the underlying may be trading at the expiry of the <i>option</i> . The knock-out type is cancelled if the underlying price or rate trades through the trigger; while the knock-in becomes activated if the price moves through the trigger.	
Corridor <i>option</i>	Provides the holder with a pay-out for each day that the underlying stays within a defined range chosen by the investor.	
Ladder <i>option</i>	Provides the holder with guaranteed pay-outs if the underlying trades through a pre-agreed price(s) or rate(s) at a certain point(s) in time, regardless of future performance.	
Lock-in <i>option</i>	An <i>option</i> where the pay-out to the holder is locked in at the maximum (or minimum) value of the underlying that occurred during the life of the <i>option</i> .	
Look-back <i>option</i>	An European style <i>option</i> where the strike price is fixed in retrospect, that is at the most favourable price (i.e. the lowest (highest) price of the underlying in the case of a call (put)) during the life of the <i>option</i> .	

Forward starting <i>option</i>	An <i>option</i> that starts at a future date.	
Compound <i>option</i>	An <i>option</i> where the underlying is itself an <i>option</i> (i.e. an <i>option</i> on an <i>option</i>).	
Interest rate cap	An interest rate <i>option</i> or series of <i>options</i> under which a <i>counterparty</i> contracts to pay any interest costs arising as a result of an increase in rates above an agreed rate: the effect being to provide protection to the holder against a rise above that agreed interest rate.	Standard method, but no reduction for the amount the <i>option</i> is <i>out of the money</i> is permitted.
Interest rate floor	An interest rate <i>option</i> or series of <i>options</i> under which a <i>counterparty</i> contracts to pay any lost income arising as a result of a fall in rates below an agreed rate: the effect being to provide protection to the holder against a fall below that agreed interest rate.	
Performance <i>option</i>	An <i>option</i> based on a reference basket comprising any number of assets, where the pay-out to the holder could be one of the following: the maximum of the worst performing asset, or 0; the maximum of the best performing asset, or 0; the maximum of the spreads between several pairs of the assets, or 0.	Standard method or hedging method - using the highest <i>PRA</i> of the individual assets in the basket
Quanto	Quanto stands for “Quantity Adjusted <i>Option</i> ”. A quanto is an instrument where two currencies are involved. The payoff is depended on a variable that is measured in one of the currencies and the payoff is made in the other currency.	Subject to 31R, the standard method
Cliquet <i>option</i>	A cliquet <i>option</i> consists of a series of forward starting <i>options</i> where the strike price for the next exercise date is set equal to a positive constant times the underlying price as of the previous exercise date. They initially act like a vanilla <i>option</i> with a fixed price but as time moves on, the strike is reset and the intrinsic value automatically locked in at pre-set dates. If the underlying price is below the previous level at the reset date no intrinsic value is locked in but the strike price will be reset to the current price attained by the underlying. If the underlying price exceeds the current level at the next reset the intrinsic value will again be locked in.	Standard method for a purchased cliquet, or the method specified in 30R for a written cliquet
Digital <i>option</i>	A type of <i>option</i> where the pay-out to the holder is fixed. The most common types: all-or-nothing and one-touch <i>options</i> . All-or-nothing will pay out the fixed amount if the underlying is above (call) or below (put) a set value at expiry. The one-touch will pay the fixed amount if the underlying reaches a fixed point any time before expiry.	The method specified in 29R
Any other		The method

<i>option or warrant</i>		specified for the type of instrument whose description it most closely resembles.
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19 R In table 18R:

- (1) "standard method" refers to the method specified in 20R to 22R; and
- (2) "hedging method" refers to the method specified in 23R to 28R.

The standard method

PURCHASED OPTIONS AND WARRANTS

20 R Under the standard method, the *PRR* for a purchased *option* or *warrant* is the lesser of:

- (1) the market value of the derived position (see 9R) multiplied by the appropriate *PRA* (see 8R); and
- (2) the market value of the *option* or *warrant*.

WRITTEN OPTIONS AND WARRANTS

21 R Under the standard method, the *PRR* for a written *option* or *warrant* is the market value of the derived position (see 9R) multiplied by the appropriate *PRA* (see 8R). This result may be reduced by the amount the *option* or *warrant* is *out of the money* (subject to a maximum reduction to zero).

UNDERWRITING OR SUB-UNDERWRITING AN ISSUE OF WARRANTS

22 R Under the standard method, the *PRR* for *underwriting* or *sub-underwriting* an issue of *warrants* is the net *underwriting* position (or reduced net *underwriting* position) multiplied by the current market price of the underlying *securities* multiplied by the appropriate *PRA*, but the result can be limited to the value of the net *underwriting* position (or reduced net *underwriting* position) calculated using the issue price of the *warrant*.

The hedging method

23 G The hedging method involves *option PRR* being calculated on a combination of the *option* and its hedge.

24 R Under the hedging method a *firm* must calculate *PRR* for individual positions as follows:

- (1) for an *option* or *warrant* on an *equity*, basket of *equities* or *equity* index and its *equity* hedge(s), to the extent specified or permitted in table 26R, using the calculation in table 27R;
- (2) for an *option* or *warrant* on a debt *security*, basket of debt *securities* or debt *security* index and its debt *security* hedge(s), to the extent specified or permitted in table 26R, using the calculation in table 27R;
- (3) for an *option* on gold and its gold hedge, to the extent specified or permitted in table 26R, using the calculation in table 27R; and
- (4) for an *option* on a currency and its currency hedge, to the extent specified or permitted in table 26R, using the calculation in table 28R.

25 R A *firm* may not use the hedging method for:

- (1) an interest rate *option* and its hedge; or
- (2) a *commodity option* and its hedge.

26 R Table: Appropriate treatment for *equities*, debt *securities* or currencies hedging *options* (see 24R)

Hedge	PRR calculation for the hedge	Limits (if the hedging method is used)	Naked positions
An <i>equity</i> (hedging an <i>option</i> or <i>warrant</i>)	The <i>equity</i> must be treated in either appendix 5 (<i>equity PRR</i>) or the hedging method (table 27R)	The hedging method must only be used up to the amount of the hedge that matches the notional amount underlying the <i>option</i> or <i>warrant</i>	To the extent that the amount of the hedge (or <i>option</i>) exceeds the notional amount underlying the <i>option</i> or <i>warrant</i> (or hedge), a <i>firm</i> must apply an <i>equity PRR</i> , interest rate <i>PRR</i> or foreign exchange <i>PRR</i> (or <i>option PRR</i>)
A debt <i>security</i> (hedging an <i>option</i> or <i>warrant</i>)	The debt <i>security</i> must be treated in appendix 4 (interest rate <i>PRR</i>) or the hedging method (table 27R)		
Gold (hedging a gold <i>option</i>)	The gold must be treated in either appendix 8 (foreign exchange <i>PRR</i>) or the hedging method (table 27R)		
A currency or currencies (hedging a currency <i>option</i>)	The currency must be treated in either appendix 8 (foreign exchange <i>PRR</i>) or the hedging method (table 28R)		

27 R Table: The hedging method of calculating the *PRR* (*equities*, debt *securities* and gold) (see 24R(1) to (3))

	<i>Option or warrant position</i>	<i>PRR</i>		
		<i>In the money by more than the PRA</i>	<i>In the money by less than the PRA</i>	<i>Out of the money</i>
Long in security	Long put	Zero	Wp	X
	Short call	Y	Y	Z
Short in security	Long call	Zero	Wc	X
	Short put	Y	Y	Z
Where:				
Wp	$[(PRA - 100\%) \times \text{The underlying position valued at strike price} + \text{The market value of the underlying position}]$			
Wc	$[(100\% + PRA) \times \text{The underlying position valued at strike price} - \text{The market value of the underlying position}]$			
X	The market value of the underlying position multiplied by the appropriate <i>PRR</i>			
Y	The market value of the underlying position multiplied by the appropriate <i>PRR</i> . This result may be reduced by the market value of the <i>option or warrant</i> , subject to a maximum reduction to zero.			
Z	The hedging method is not permitted; the standard method must be used.			

28 R Table: The hedging method of calculating the *PRR* (currencies) (see 24R(4))

		<i>PRR</i>		
<i>Option position</i>		<i>In the money by more than 8%</i>	<i>In the money by less than 8%</i>	<i>Out of the money</i>
Long calls & long puts		Zero	W_L	X
Short calls & short puts		Zero	Y	X
Where:				
W_L	[1.08 x The amount of the underlying currency that the <i>firm</i> will receive if the <i>option</i> is exercised, converted at the strike price into the currency that the <i>firm</i> will sell if the <i>option</i> is exercised			- The market value of the underlying position
X	The market value of the underlying position multiplied by 8%.			
Y	The market value of the underlying position multiplied by 8%. This result may be reduced by the market value of the <i>option</i> , subject to a maximum reduction to zero.			

Specific methods and treatments

DIGITAL OPTIONS

29 R The *PRR* for a digital *option* is the maximum loss of the *option*.

WRITTEN CLIQUET OPTIONS

30 R The *PRR* for a written cliquet *option* is the market value of the derived position (see 9R) multiplied by the appropriate *PRA* (see 8R) multiplied by $F+1$ (see below). This result may be reduced by the amount the *option* is *out of the money* (subject to a maximum reduction to zero).

$$\text{i.e. } [PRA * \text{underlying} * (F + 1)] - OTM$$

$$\text{where } F = \min \left[FR, \max \left(\frac{FR}{2}, Y \right) \right]$$

FR: Number of forward re-sets

Y: Years to maturity

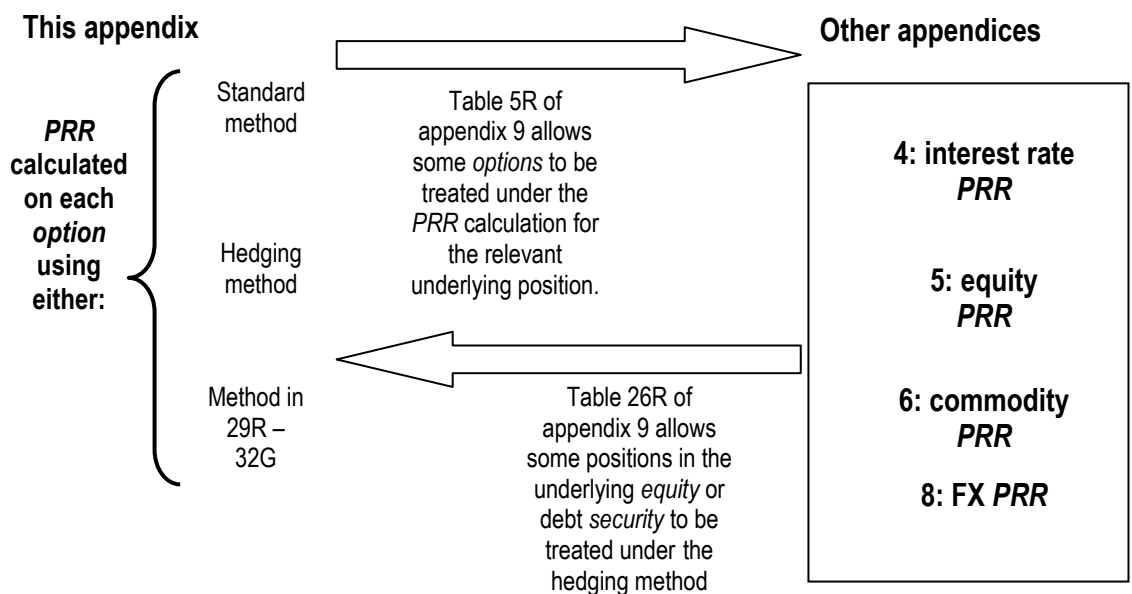
OTM: Out of the money amount

QUANTOS

- 31 R If the pay-out to the holder of a quanto *option* is fixed at the inception of the transaction a *firm* must add 8% to the *PRA* when applying the standard method.
- 32 G The additional *PRA* is to account for the forward foreign currency exchange risk.

Interaction with other appendices

- 33 G Figure: Diagram illustrating the relationship between this appendix and other appendices.



Appendix 10

Use of a CAD1 Model

Introduction

1. G A *firm* is required under 10-80(2)R to calculate *PRR* using the rules and appendices listed in table 10-80(2)R. However, the *FSA* may at the *firm's* request, waive or modify 10-80(2)R and thereby allow the *firm* to calculate all or part of its *PRR* using a "CAD1" (Capital Adequacy Directive) (for options risk aggregation and/or interest rate pre-processing) or "VaR" (value at risk) model instead. Appendix 11 deals with VaR model *waivers*.
2. G The purpose of this appendix is to provide guidance on the *FSA's* policy for granting CAD1 model *waivers* under section 148 of the *Act*. The policy recognises that CAD1 models may vary across *firms* but, as a minimum, the *FSA* will need to be satisfied about:
 - (1) the quality of the internal controls and risk management surrounding the model (see 18G to 22G for further details); and
 - (2) the quality of the model standards and that the CAD1 model captures and produces an accurate measure of the risks inherent in the portfolio covered by the CAD1 model (see 23G to 52G for further details).
3. G It also explains how the output from the model is fed into the 10-80 *PRR* calculation.
4. G If a CAD1 model recognition *waiver* is granted by the *FSA*, the *waiver* will contain certain conditions. In order to adequately address individual circumstances, these conditions may differ from the requirements set out in this appendix. The *waiver* will also confirm the *rules* to which the *waiver* applies, and the scope of CAD1 model recognition granted to a *firm*.
5. G It is generally the case that *waivers* permitting the use of models that the *FSA* is likely to grant are CAD1 and VaR models in accordance with the policy in this appendix.
6. G If a *firm* ceases to meet any of these standards, the *FSA's* policy is that the *waiver* should cease to have effect.

Scope of CAD1 models

7. G The *FSA* recognises two types of CAD1 model. The table below sets out:

Options risk aggregation models		Interest rate pre-processing models
Brief description and eligible instruments	Analyse and aggregate <i>options</i> risks for <ul style="list-style-type: none"> • interest rate <i>options</i>, • <i>equity options</i>, • foreign exchange <i>options</i>; and • <i>commodity options</i>. 	May be used to calculate duration weighted positions for: <ul style="list-style-type: none"> • interest rate <i>futures</i>; • forward rate agreements (<i>FRAs</i>); • forward commitments to buy or sell debt instruments; • <i>options</i> on interest rates, debt instruments, and <i>swaps</i>; • <i>warrants</i>; • <i>swaps</i>; • amortising bonds; • <i>equity futures, forwards</i> and <i>options</i> (but only in relation to the interest rate risk inherent in these products); and • Foreign exchange <i>futures, forwards</i> and <i>options</i>, but only in relation to the interest rate risk inherent in these products.
The output and how it is used in the <i>PRR</i> calculation	Depending on the type of model and the conditions contained in any CAD1 model <i>waiver</i> granted, the outputs from an <i>options</i> risk aggregation model may be used as an input to the <i>PRR</i> calculation set out in <i>IPRU(INV)10-80R</i> .	Depending on the type of model and the conditions contained in any CAD1 model <i>waiver</i> granted, the individual sensitivity figures produced by this type of CAD1 model may be either input into a <i>firm's</i> standard duration method <i>PRR</i> calculation (see 60R of Appendix 4) or be converted into notional positions and input into a <i>firm's</i> maturity method <i>PRR</i> (see 55R of Appendix 4).

The CAD1 model waiver application and review process

8. G Details of the general *waiver* process are set out in *SUP* 8. Because of the complexity of a CAD1 model recognition *waiver*, it is recommended that, as set out in *SUP* 8.3.3G, a *firm* contact its usual contact at the *FSA* to discuss its proposed application. It should also be noted that the *waiver* recognition process in the case of a CAD1 model recognition *waiver* may take longer than the timescales indicated in *SUP* 8.3.3G.
9. G In order to consider a CAD1 model recognition *waiver* request, the *FSA* may undertake a review to ensure that it is adequate and appropriate for the *PRR* calculation.

10. G The model review process may be conducted through a series of visits covering various aspects of the *firm's* control and IT environment. Before these visits the *FSA* may ask the *firm* to provide some information relating to its *waiver* request accompanied by some specified background material. The model review visits are organised on a timetable that allows a *firm* being visited sufficient time to arrange the visit and provide the appropriate pre-visit information.
11. G As part of the model review process, the following may be reviewed: organisational structure and personnel; details of the *firm's* market position in the relevant products; profit and risk information; valuation and reserving policies; operational controls; IT systems; model release and control procedures; risk management and control framework; risk appetite and limit structure and future developments relevant to model recognition.
12. G The *FSA* will normally require meetings with senior management and staff from the front office, financial control, risk management, operations, systems development, information technology and audit areas.
13. G A review by a *skilled person* may be used before a CAD1 model *waiver* is granted to supplement the *waiver* process, or after the *waiver* has been granted to review the CAD1 model.
14. G If the *FSA* grants a *waiver* to allow the use of a CAD1 model, the *waiver* direction will specify the particular rule which has been modified, and set out the conditions on which the *waiver* has been granted. Conditions may include:
 - (1) the details of the calculation of *PRR*;
 - (2) the CAD1 model methodology to be employed;
 - (3) the products covered by the model (e.g. *option* type, maturity, currency);
 - (4) any notification requirements relating to the CAD1 model *waiver*; and
 - (5) any other conditions attached to the CAD1 model *waiver*.
15. G Where a *firm* operates any part of its CAD1 model outside the United Kingdom, the *FSA* may take into account the results of any home state supervisor's model review. The *FSA* may wish to receive information directly from the home state supervisor.

Maintenance of model recognition

16. G No changes should be made to a CAD1 model unless the change is not material. Material changes to a CAD1 model will require a renewed *waiver* to be issued. Materiality is measured from the time that the *waiver* is granted or, if the *waiver* has been varied in accordance with section 148 of the *Act*, the time of that variation. If a *firm* is considering making material changes to its CAD1 model, then it should notify the *FSA* at once. A *firm* must re-apply for a *waiver* if the products covered by the model change.
17. G If the CAD1 model ceases to meet the conditions of the *waiver*, the *firm* should notify the *FSA* at once. The *FSA* may then revoke the *waiver*, unless it is varied in accordance with section 148 of the *Act*.

Risk management standards

18. G A *firm* with a complex portfolio is expected to demonstrate more sophistication in its modelling and risk management than a *firm* with a simple portfolio.
19. G A *firm* should be able to demonstrate that it meets the risk management standards set out in this appendix for each legal entity that will have the benefit of the CAD1 model *waiver*. This is particularly important for subsidiaries in *groups* subject to matrix management where the business lines cut across legal entity boundaries.
20. G A *firm* should have a conceptually sound risk management system which is implemented with integrity and should meet the following minimum standards:
 - (1) A *firm* should have a risk control unit that is independent of business trading units and reports directly to senior management. The unit should be responsible for designing and implementing the *firm's* risk management system. It should produce and analyse daily reports on the risks run by the business and on the appropriate measures to be taken in terms of the trading limits.
 - (2) A *firm's* senior management should be actively involved in the risk control process, and the daily reports produced by the risk control unit should be reviewed by a level of management with sufficient authority to enforce reductions of positions taken by individual traders as well as in the *firm's* overall risk exposure.
 - (3) The risk control group should have a sufficient number of staff with appropriate skills in the use of models.
 - (4) A *firm* should have established procedures for monitoring and ensuring compliance with a documented set of appropriate internal policies and controls concerning the overall operation of the risk measurement and control framework. This should take into account the front, middle and back office functions.
 - (5) A *firm* should conduct, as part of its internal audit process, a review of the systems and controls surrounding its CAD1 model. This review should include the valuation process, compliance with the CAD1 model scope and the activities of the business trading units and the risk control units. This review should be undertaken by staff independent of the areas being reviewed.
21. G In assessing whether the risk management and control framework is implemented with integrity, the *FSA* will consider the IT systems used to run the CAD1 model and associated calculations. The assessment will include, where appropriate:
 - (1) feeder systems; risk aggregation systems; the integrity of the data (i.e. it is complete, coherent and correct); reconciliations and checks on completeness of capture; and
 - (2) system development, change control and documentation; security and audit trails; system availability and contingency procedures; network adequacy.
22. G A *firm* should take appropriate steps to ensure that it has adequate controls surrounding:
 - (1) the derivation of the *PRR* from the CAD1 model output;

- (2) CAD1 model development, including independent validation;
- (3) reserving;
- (4) valuation (see *IPRU(INV)10-41(9)R*), including independent validation; and
- (5) the adequacy of the IT infrastructure.

Model standards

23. G A *firm* should take appropriate steps to ensure that its CAD1 model captures and produces an accurate measure of the risks inherent in the portfolio covered by the CAD1 model. These risks may include, but are not limited to, gamma, vega and rho.

OPTIONS RISK AGGREGATION MODELS

24. G For a *firm* to obtain a CAD1 model *waiver* for its *options* risk aggregation model, it should have in place an appropriate *options* valuation model.
25. G The *FSA* does not specify the methodology that a *firm* should employ in order to produce the appropriate outputs from its CAD1 model. However, 26G to 42G provide details of how a *firm* could meet the requirements to capture gamma, vega and rho risks using a scenario matrix approach. Where a *firm* adopts the scenario matrix approach then the standards set out in 26G to 42G should be followed. The *firm* should also take into account other risks not captured by the scenario matrix approach. Otherwise, a *firm* may use an equivalent methodology. If a *firm* uses an equivalent methodology, then it will need to demonstrate that the approach used meets the requirements of this appendix.
26. G A scenario matrix is an approach by which an *options* portfolio is revalued given a number of simultaneous shifts in both the spot level of the underlying and the implied volatility.
27. G The scenario matrix approach may be employed for all types of *options* on all types of underlying asset.
28. G The following provides an outline of the initial steps to be taken when using the scenario matrix approach:
 - (1) A value for an *option* should be obtained using the *firm's options* valuation model.
 - (2) The inputs into the *options* valuation model for implied volatility of the underlying asset and the price of the underlying asset should then be altered so that a new value for the *option* is obtained (details of the amount by which the implied volatility and the price of the underlying should be amended are set out in 29G-35G).
 - (3) The difference between the original value of the *option* and the new value obtained following the alterations should be input into the appropriate cell in the matrix, the value in the central cell where there is no change in implied volatility or price of the underlying should therefore be zero.

- (4) The process of obtaining a new price for the *option* should be repeated until the matrix is completed.
29. G The alteration to the implied volatility (known as the implied volatility shift) referred to in 28(2)G may be a proportional shift, the size of which depends on the remaining life of the *option* and the asset class of the underlying. Table 31G sets out the shifts that should be applied where a proportional shift is used. Alternatively, a *firm* may use a single shift across all maturities or use an absolute rather than a proportional implied volatility shift. Where an absolute shift is used it should be at least as conservative as the proportional shifts. This should be reviewed and, if necessary updated, on a regular basis.
30. G A *firm* may choose to use a less detailed term structure than that in Table 31G, but the shifts used should be no less conservative than those set out. For example, a *firm* that uses one <3 month band, rather than the two bands (<1 month, and 1-3 months) set out in the table, should use the most conservative shift set out in the table for the bands covered that is, 30% for the <3 month band.
31. G TABLE: PROPORTIONAL IMPLIED VOLATILITY SHIFTS (SEE 29G)

REMAINING LIFE OF OPTION	PROPORTIONAL SHIFT	
	EQUITIES & FX & COMMODITIES	INTEREST RATES
≤1 month	30%	30%
>1≤3 months	20%	20%
>3≤6 months	15%	15%
>6≤9 months	12%	12%
>9≤12 months	9%	9%
>1≤2 years	6%	9%
>2≤4 years	4.5%	9%
>4 years	3%	9%

32. G The size of the underlying price/rate shift depends on the asset class of the underlying and is set out in 33G:
33. G TABLE: UNDERLYING PRICE/RATE SHIFTS (SEE 32G)

UNDERLYING ASSET CLASS	SHIFT
Equities	±8%
Foreign Exchange	±8%
Commodities	±15%, (but a <i>firm</i> may use the percentages applicable under the extended maturity ladder approach, where permitted by the requirements of Appendix 6).
Interest Rates	±100bp (but a <i>firm</i> may use the sliding scale of shifts by maturity as outlined in Appendix 4).

34. G The shifts outlined above are the maximum shifts required; in addition there will be a number of intermediate shifts as a result of the minimum matrix size criteria set out in 35G.
35. G The minimum size of the scenario matrix should be 3x7, that is, three observations for implied volatility (including the actual implied volatility) and seven observations for the price of the underlying (including the actual price of the underlying). A *firm* should be able to justify its choice of granularity. Greater granularity may be required where the portfolio contains, for example, a large proportion of barrier *options*.
36. G A different scenario matrix should be set up for each underlying asset type:
- (1) for *equities* (including single *equities*, baskets and indices) this means a separate matrix for each national market or non-decomposed basket or non-decomposed multi-national index;
 - (2) for *foreign exchange* products this means a separate matrix for each currency pair where appropriate;
 - (3) for *commodity* products this means a separate matrix for each underlying as defined in Appendix 6; and
 - (4) for interest rate products this means a separate matrix for each currency; in addition, a *firm* should not offset the gamma and vega exposures (except in the circumstances set out in 37G) arising from any one of the following types of products with the gamma and vega exposures arising from any of the other products in the list:
 - (a) swaptions (options on interest rates);
 - (b) interest rate *options* (including *options* on exchange-traded *deposit* or bill *futures*);
 - (c) bond *options* (including *options* on exchange-traded bond *futures*);

- (d) other types of exotic *option* which do not fall easily into one of the other three categories and are required by the *FSA* to form their own separate underlying asset.
37. G A *firm* may offset gamma and vega exposures arising from the products listed in 36(4)G where it can demonstrate that it trades different types of interest rate-related *options* as a portfolio and takes steps to control the basis risk between different types of implied volatility. If this is the case, then an individual matrix is not required for each of the products listed in 36(4)G and a combined scenario matrix may be used.
38. G Where it is imprudent to fully offset long-dated and short-dated vega exposure due to non-parallel shifts in the yield curve, a *firm* should use an appropriate number of scenario matrices to take account of non-parallel shifts in the yield curve according to the maturity of the *option* or underlying.
39. G Following the steps outlined in 28G, a *firm* then removes the portion of the values in the matrix that can be attributed to the effect that delta has had on the change in the value of the *option* (a process known as delta-stripping).
40. G Once the effect of delta has been removed from the matrix, the values left in the matrix relate to gamma and vega risk. A *firm's PRR* in relation to gamma and vega risk on the individual *option* is the absolute of the most negative cell in the scenario matrix produced. Where all cells are positive the *PRR* is zero. The total *PRR* for the gamma and vega risk on the portfolio of *options* is a simple sum of the individual requirements. This amount should then be fed into a *firm's PRR* calculation.
41. G The values that have been obtained for the delta-equivalent positions of instruments included in the scenario matrix should then be treated in the same way as positions in the underlying. Where the delta obtained relates to interest rate position risk, the delta equivalent positions may be fed into a *firm's* interest rate pre-processing model providing that the positions fall within the scope of the interest rate pre-processing model set out in 7G, and that the *firm* has the appropriate CAD1 model *waiver*. Alternatively, the delta obtained should be fed into the standard *PRR* calculation in Appendix 4, 5, 6 or 8 as appropriate.
42. G In using the scenario matrix approach, none of the steps followed will take specific account of a *firm's* exposure to rho risk. Where a *firm* can demonstrate that for interest rate-related *options* the rho sensitivity is effectively included in the delta sensitivities produced, there is no separate capital requirement relating to rho. For all other *options* except commodity *options*, a *firm* should calculate a rho sensitivity ladder by currency as part of its CAD1 model and feed this either into the maturity or duration method *PRR* calculation set out in Appendix 4 or, where a *firm* has the appropriate *waiver*, into an interest rate pre-processing model.

INTEREST RATE PRE-PROCESSING MODELS

43. G A *firm* granted a *waiver* to use an interest rate pre-processing model is permitted to use it for the pre-processing of the instruments set out in 7G, from which the residual positions are fed into the maturity or duration method *PRR* calculation as set out in Appendix 4.

44. G There are a number of different methods of constructing pre-processing models. All pre-processing models should generate positions that have the same sensitivity to defined interest rate changes as the underlying cash flows.
45. G In an interest rate pre-processing model each transaction is converted into its constituent cash flows. The cash flows are discounted using zero coupon rates derived from the *firm's* own yield curves.
46. G The cash flows are then calculated again using the *firm's* own yield curve shifted by the amount set out in 48G.
47. G The difference between the present values calculated using the *firm's* own yield curve and those calculated using the *firm's* curve shifted by the amount specified are known as the sensitivity figures. Alternatively, *firms* may shift the yield curve by one basis point and multiply the sensitivity figures up by the appropriate amount in order to achieve the shifts set out in 48G. These sensitivity figures are then allocated to each of the 15 maturity bands set out in 48G.
48. G TABLE: YIELD CURVE SHIFTS (SEE 46G)

Zone	Modified Duration	Assumed interest rate change (percentage points)
1	0 ≤ 1 months	1.00
	> 1 ≤ 3 months	1.00
	> 3 ≤ 6 months	1.00
	> 6 ≤ 12 months	1.00
2	> 1.0 ≤ 1.9 years	0.90
	> 1.9 ≤ 2.8 years	0.80
	> 2.8 ≤ 3.6 years	0.75
3	> 3.6 ≤ 4.3 years	0.75
	> 4.3 ≤ 5.7 years	0.70
	> 5.7 ≤ 9.3 years	0.65
	> 7.3 ≤ 9.3 years	0.60
	> 9.3 ≤ 10.6 years	0.60
	> 10.6 ≤ 12 years	0.60
	> 12.0 ≤ 20 years	0.60
	> 20 years	0.60

49. G Sensitivity figures calculated by a *firm* using an interest rate pre-processing model are usually produced in the format of a net sensitivity by maturity bucket or by discrete gridpoint. These maturity buckets or gridpoints should then be allocated to the 15 bands set out in 48G. The number of maturity buckets or gridpoints used to represent a yield curve can be referred to as granularity. It is not a requirement that each of the 15 bands for *firms* have one or more maturity buckets or gridpoints allocated; however, for all *firms* the granularity should be adequate to capture the material curve risk in the portfolio. Curve risk can be defined as the risk associated with holding long and short positions at different points along the yield curve.

50. G Positive and negative amounts in each of the different maturity bands of the sensitivity calculation should then be netted off to produce one figure for each of the bands. There is no capital requirement for this netting process.
51. G The individual sensitivity figures produced should then be input into a *firm's* duration method *PRR* calculation as set out in Appendix 4. The individual sensitivity figures for each band should be included with the other positions in the weighted net positions column used in the duration method.
52. G Alternatively, *firms* may choose to use an approach based on the maturity method set out in Appendix 4, making appropriate adjustments to the sensitivity figures.

Appendix 11

Use of a Value at Risk Model

Introduction

- 1 G This appendix provides details of when the *FSA* expects to allow a *firm* to use its own Value at Risk (VaR) model for the purpose of calculating part or all of its *PRR*, and explains how the model will relate to the standard rules.
- 2 G The models described in this appendix are described as VaR models in order to distinguish them from the kinds of model originally contemplated by the previous version of the *Capital Adequacy Directive i.e.* (Directive 93/6/EEC). (These are covered in Appendix 10 and referred to as "CAD 1 models".) A VaR model is a risk management model which uses a statistical measure to predict profit and loss movement ranges with a confidence interval.
- 3 G The aim of the VaR model approach is to enable a *firm* with adequate risk management systems to benefit from more accurate *financial resources requirements* than those generated by standard requirements, and to provide a *firm* with an incentive to measure market risks as accurately and comprehensively as possible. It is crucial that those responsible for managing market risk at a *firm* should be aware of the assumptions and limitations of the *firm's* VaR model.
- 4 G A VaR measure provides an estimate of the worst expected loss on a portfolio resulting from market movements over a period of time with a given confidence level. The *PRR* relating to the risks covered by the VaR model is based on the value produced by the VaR model. In undertaking the *PRR* calculation, a *firm* should apply a multiplication factor to the value produced by the VaR model (details of how the multiplication factor will affect a *PRR* are set out in 76G). The multiplication factor that should be applied is set by the *FSA*. The multiplication factor may be increased by a plus factor, which relates to the results of a *firm's* back-testing process (for further details on the plus factor see 63G).
- 5 G There are a number of methodologies for calculating *PRR* using a VaR model. These include variance-covariance, historical simulation, Monte Carlo or a hybrid of these. Although the section on model standards in this appendix sets out some general model standards that should be met, the *FSA* does not prescribe any one method of computing *PRR* using a VaR model. Moreover, it does not wish to discourage any *firm* from developing alternative risk measurement techniques. A *firm* should discuss the use of any alternative techniques used to calculate *PRR* with the *FSA*.

Overview

[LINK TO STANDARD PRR RULES](#)

- 6 G 10-80(2)R requires a *firm* to use the rules in appendices 4 to 9 to calculate *PRR*. Therefore, a *firm* needs to apply for a *waiver* in order to calculate its *PRR* using a VaR model instead of (or in combination with) the standard approaches required under 10-80(2)R.
- 7 G The VaR Model based *PRR* produced in accordance with this appendix should be included in the *firm's PRR* calculation set out in 10-80(2)R. The VaR model *PRR* should be used in place of the appropriate *PRR* for the risks covered by the VaR model.

BASIC REQUIREMENTS / SUMMARY OF CHAPTER

- 8 G Details of the general *waiver* process can be found in *SUP* 8. The *FSA* will not normally grant a VaR model *waiver* unless it is satisfied about the quality of:
- (1) the internal controls and risk management surrounding the VaR model (see 29G to 36G);
 - (2) the VaR Model Standards (see 37G to 45G);
 - (3) risk management standards including stress testing and backtesting procedures surrounding a VaR model; (see 46G to 74G); and
 - (4) the procedures in place at a *firm* to calculate its VaR model based *PRR*.
- 9 G The *FSA* recognises that the nature of VaR models will vary across *firms*. The scope of and the conditions set out in a VaR model *waiver* may therefore differ in substance or detail from the matters described in this appendix in order to address individual circumstances adequately. For example, a VaR model *waiver* may also include additional conditions to meet the particular circumstances of the *firm* or the model.
- 10 G If the *firm* ceases to meet any of these standards, the *FSA's* policy is that the *waiver* should cease to have effect. In many cases the ongoing need to meet these standards will be included in the *waiver* direction by imposing certain conditions. Even if they are not formally included as conditions, the *FSA* is likely to consider revoking the *waiver* if the standards are not met.
- 11 G The VaR Model Waiver Application and Review section of this appendix sets out the *FSA's* general policy on the VaR model application and review process and the conditions that the *FSA* may impose relating to alterations of the model.
- 12 G It is generally the case that the *waivers* permitting the use of models that the *FSA* is likely to grant are CAD1 and VaR models in accordance with the policy in this appendix.

SCOPE OF VAR MODELS

- 13 G This appendix sets out the *FSA's* policy on the scope of a VaR model *waiver* and the manner in which the outputs of the model will be incorporated in the calculation set out in 10-80(2). Some of the standards described in this appendix may also be reflected in conditions attached to a VaR model *waiver*.
- 14 G A VaR model will be expected to cover one or more of the following types of risk category:
- (1) interest rate general market risk;
 - (2) interest rate specific risk (in conjunction with interest rate general market risk);
 - (3) *equity* general market risk;
 - (4) *equity* specific risk (in conjunction with equity general market risk);
 - (5) foreign-exchange risk; and
 - (6) *commodity* risk.
- 15 G It is the *FSA's* view that, where a *firm* uses a VaR model for one risk category, it is good practice to extend its model over time to calculate all of its *PRR* risk categories.
- 16 G For the purposes of 10-80(2)R, where a combination of the standard *PRR* rules, CAD1 model and VaR model approaches is used the *PRR* from each method should be added together. A *firm* should take appropriate steps to ensure that all of the approaches mentioned are applied in a consistent manner. For example, where the *PRR* for a particular portfolio is normally calculated using a VaR model, it should not switch between the standard market risk rules and a VaR model approach purely to achieve a more attractive *PRR*.
- 17 G A *firm* will not be required to capture immaterial risk or the market risk inherent in new products in a VaR model. If a *firm* does not capture immaterial risks or the market risk inherent in a new product in a VaR model, then the appropriate standard *PRR* rules to these risks will apply.

The VaR model waiver application and review process

- 18 G Details of the general *waiver* process are set out in *SUP* 8. Because of the complexity of a VaR model recognition *waiver*, it is recommended that, as set out in *SUP* 8.3.3G, a *firm* discusses its proposed application with its usual contact at the *FSA*. It should also be noted that the *waiver* recognition process in the case of VaR model recognition *waivers* is likely to take longer than the time-scale guidance set out in *SUP* 8.3.3G.
- 19 G In order for a VaR model recognition *waiver* to be granted, the *FSA* is likely to undertake a review to ensure that it is adequate and appropriate for the *PRR* calculation.

- 20 G The VaR model review process may be conducted through a series of visits covering various aspects of a *firm's* control and IT environment. Before these visits the *FSA* may ask that the *firm* provides some information relating to the *firm's waiver* request accompanied by some specified background material. The VaR model review visits are organised on a timetable that allows the *firm* being visited sufficient time to arrange the visit and provide the appropriate pre-visit information.
- 21 G As part of the of the VaR model review process the following may be reviewed: organisational structure and personnel; details of the *firm's* market position in the relevant products; profit and risk information; valuation and reserving policies; operational controls; IT systems; model release and control procedures; risk management and control framework; risk appetite and limit structure and future developments relevant to model recognition.
- 22 G A visit will usually involve the *FSA* wishing to meet senior management and staff from the front office, financial control, risk management, operations, systems development, information technology and internal audit areas.
- 23 G The *FSA* may complement its own review of a VaR model *waiver* request with one or more reviews by a *skilled person* under section 166 of the *Act*. Such a review may also be used where a VaR model *waiver* has been granted to ensure that the standards on which a VaR model *waiver* was based continue to be met.
- 24 G As set out in 9G the *FSA* will issue a *waiver* containing certain conditions. These conditions are likely to cover the standards described in this appendix to the extent that they are relevant to the circumstances, and may set out:
- (1) the details of the calculation of VaR model based *PRR*, which will contain the multiplication factor to be applied;
 - (2) the method of separating out specific risk if appropriate;
 - (3) the method agreed of calculating profit and loss accounts for backtesting purposes;
 - (4) the circumstances in which model refinements, new products, new markets and new locations should be notified to the *FSA*;
 - (5) any notification requirements relating to the VaR model *waiver*;
 - (6) any additional reporting requirements (e.g. electronic reporting of backtesting results);
 - (7) details of the changes to the VaR model which would be considered material by the *FSA*; and
 - (8) any other conditions attached to the VaR model *waiver*.
- 25 G Where a VaR model used outside of the United Kingdom differs from that used in the United Kingdom a *firm* the *FSA* may request details on the reasons for using different models.

- 26 G Where a *firm* operates any part of its VaR model outside of the United Kingdom, the *FSA* may take into account the results of the home supervisor's VaR model review. The *FSA* may wish to receive information directly from the home supervisor.

MAINTENANCE OF VAR MODEL WAIVER

- 27 G No changes may be made to a VaR model which is the subject of a *waiver* direction, unless the change is not material. Material changes to a VaR model will require a renewed *waiver* to be issued. Materiality is measured against the VaR model as it was at the time that the *waiver* was originally granted or, if the *waiver* has been varied in accordance with section 148 of the *Act*, as it was at the time of that variation. If a *firm* is considering making material changes to its VaR model then it should notify the *FSA* at once.
- 28 G If the VaR model ceases to meet the conditions of the *waiver*, a *firm* should notify the *FSA* at once. The *FSA* is likely then to revoke the *waiver*, unless it is varied in accordance with section 148 of the *Act*.

Risk management standards

- 29 G A *firm* with a complex portfolio is expected to demonstrate more sophistication in its modelling and risk management than a *firm* with a simple portfolio. For example, a *firm* will be expected to consider, where necessary, varying degrees of liquidity for different risk factors, the complexity of risk modelling across time zones, product categories and risk factors. Some trade-off is permissible between the sophistication and accuracy of the model and the conservatism of underlying assumptions or simplifications.
- 30 G A *firm* should be able to demonstrate that it meets the risk management standards set out in this section on a legal entity basis. This is particularly important for subsidiaries of *groups* subject to matrix management where the business lines cut across legal entity boundaries.
- 31 G A *firm* should have a conceptually sound risk management system surrounding the use of a VaR model which is implemented with integrity and should meet the following minimum standards:
- (1) the VaR model should be fully integrated into the daily risk management process of the *firm*, and serve as the basis for reporting risk exposures to senior management of the *firm*;
 - (2) a *firm* should have a risk control unit which is independent from business trading units, and which reports directly to senior management. The unit should be responsible for designing and implementing the *firm's* risk management system. It should produce and analyse daily reports on the output of the model and on the appropriate measures to be taken in terms of the trading limits;

- (3) a *firm's* directors and senior management should be actively involved in the risk control process, and the daily reports produced by the risk control unit should be reviewed by a level of management with sufficient authority to enforce both reductions of positions taken by individual traders as well as in the *firm's* overall risk exposure;
- (4) a *firm* should have sufficient numbers of staff skilled in the use of sophisticated models in the trading, risk control, audit and back office areas;
- (5) a *firm* should have established procedures for monitoring and ensuring compliance with a documented set of appropriate internal policies and controls concerning the overall operation of the risk measurement system;
- (6) a *firm's* VaR model should have a proven track record of acceptable accuracy in measuring risk;
- (7) a *firm* should conduct a programme of stress testing frequently, and the results of these tests should be reviewed by senior management and reflected in the policies and limits set;
- (8) a *firm* should have procedures to ensure that the valuation of assets and liabilities is appropriate, and that valuation uncertainty is identified and appropriate reserving is undertaken where necessary; and
- (9) at least once a year, a *firm* should conduct, as part of its regular internal audit process, a review of its risk management process. This review should include both the activities of the business trading units and of the independent risk control unit, and should be undertaken by suitably qualified staff independent of the areas being reviewed. This review should consider, at a minimum:
 - (a) the adequacy of the documentation of the risk management system and process;
 - (b) the organisation of the risk control unit;
 - (c) the integration of market risk measures into daily risk management and the integrity of the management information system;
 - (d) the process for approving risk pricing models and valuation systems used in front and back offices;
 - (e) the validation of any significant changes in the risk management process;
 - (f) the scope of risks and products captured by the VaR model;
 - (g) the accuracy and completeness of position data;
 - (h) the process used to ensure the consistency, timeliness, independence and reliability of data sources;
 - (i) the accuracy and appropriateness of volatility and correlation assumptions;

- (j) reserving policies, the accuracy of the valuation procedures, and risk sensitivity calculations;
 - (k) the process employed to evaluate the VaR model's accuracy, including the programme of backtesting;
 - (l) the controls surrounding VaR model development; and
 - (m) the process employed to produce the VaR model based *PRR*.
- 32 G A *firm's* VaR model output should be an integral part of the process of planning, monitoring and controlling a *firm's* market risk profile. The VaR model should be used in conjunction with internal trading and exposure limits. The links between these limits and the model should be consistent over time and understood by senior management.
- 33 G A *firm* should have adequate VaR model validation procedures to assess its model, and should have procedures in place to ensure that both the assumptions and approximations underlying the model and the limits of the model are appropriate. It should undertake testing of the accuracy of parts of the VaR models as well as the whole model. The *FSA* will require a period of initial monitoring or live testing before a VaR model can be recognised. Backtesting should be regarded as an additional safeguard rather than the primary model validation tool. A *firm* should therefore ensure that it has appropriate methods of assessing model validity and does not rely purely on the results of backtesting.
- 34 G In assessing whether the VaR model is implemented with integrity, the *FSA* will consider in particular the IT systems used to run the model and associated calculations. The assessment may include:
- (1) feeder systems; risk aggregation systems; time series databases; the VaR model system; stress testing system; the backtesting system including profit & loss cleaning systems where appropriate; data quality; reconciliations and checks on completeness of capture;
 - (2) system development, change control and documentation; security and audit trails; system availability and contingency procedures; network adequacy; and
 - (3) operational statistics relating to VaR model production process; examples of these statistics are timeliness, number of re-runs required and the reliability of data feeds.
- 35 G It is the responsibility of a *firm's* own management to ensure the accuracy and integrity of its VaR model. This responsibility includes obtaining appropriate independent validation of the VaR model.
- 36 G A *firm* should ensure that it has adequate controls surrounding:
- (1) the derivation of the VaR model based *PRR*;
 - (2) the integrity of the backtesting programme, including the calculation of the profit and loss account;

- (3) the integrity and appropriateness of the VaR model, including the model's geographic coverage and the completeness of data sources;
- (4) the VaR model's initial and ongoing development, including independent validation;
- (5) the valuation models, including independent validation; and
- (6) the adequacy and security/integrity of the IT infrastructure.

Model standards

- 37 G A *firm* should base its *PRR* calculation on the output of the VaR model which is used for its internal risk management rather than one developed specifically to calculate its *PRR*.
- 38 G The *FSA* accepts that the scope and nature of VaR models varies across *firms*. This means that different *firms* are likely to calculate different estimates of market risk for the same portfolio. Systematic differences are due to length of data series, choice of methodology (historical or Monte Carlo simulation or variance-covariance method or a hybrid of these), differences in aggregating risks within and across broad risk factors, the treatment of *options* and other non-linear products and the specification of risk factors.
- 39 G A *firm* that chooses to apply for a *waiver* to use a VaR model for the calculation of its *PRR* should calculate its market risk using the appropriate model parameters as set out in 40G.
- 40 G A *firm* should calculate its market risk by adopting the following minimum standards:
- (1) VaR should be calculated at least daily, using a 99% one-tailed confidence limit.
 - (2) VaR should be calculated using a holding period equivalent to ten *business days*.
 - (3) VaR measures should be based on an effective historical observation period of at least one-year, except where a shorter observation period is justified by a significant change in price volatility. If a weighting scheme or other method is used, then the effective observation period should be at least one year. The weighted average time lag of the individual observations should not be less than six months.
 - (4) Data sets should be updated no less frequently than quarterly, and more frequently whenever market prices are subject to material change.
- 41 G A *firm* may meet the appropriate model parameter requirement by using different model parameters and employing a suitable adjustment mechanism to produce a VaR figure which is equivalent to the figure produced using the parameters set out in 40G. For example, a *firm's* own model may use a 95% one-tailed confidence limit, but a mechanism to convert the output of the model to reflect a 99% one-tailed confidence limit should be employed.

RISK FACTORS

- 42 G A VaR model should capture and accurately reflect, on a continuing basis, all material general market risks and, where a VaR model *waiver* has been granted in relation to specific risk, specific risks arising on the underlying portfolio, and should ensure that sufficient risk factors are properly specified.

GENERAL MARKET RISK

- 43 G A *firm's* VaR model should capture a sufficient number of risk factors in relation to the level of activity of the *firm*, in particular the following:
- (1) For interest rate risk, the VaR model should incorporate a set of risk factors corresponding to the interest rate curves in each currency in which the *firm* has interest rate sensitive positions. A *firm* should ensure that it captures the variations of volatility of rates along the yield curve. In order to achieve this, a *firm* should divide the yield curves of, at a minimum, the major currencies and markets where it has material interest rate exposures into a minimum of six maturity segments. The risk measurement system should also capture the risk of less than perfectly correlated movements between different yield curves.
 - (2) For foreign exchange risk, the VaR model should incorporate risk factors corresponding to the individual foreign currencies, including gold, in which the *firm's* positions are denominated.
 - (3) For *equity* risk, the VaR model should use a separate risk factor at least for each of the *equity* markets in which the *firm* has material exposures.
 - (4) For *commodity* risk, the VaR model should use a separate risk factor at least for each *commodity* in which the *firm* has material exposures. The VaR model should capture the risk of less than perfectly correlated movements between similar, but not identical, *commodities* and the exposure to changes in forward prices arising from maturity mismatches. It should also take account of market characteristics, notably delivery dates and the scope provided to traders to close out positions.
 - (5) A *firm* that deals in *options*, or products with *option*-like characteristics, should ensure that their VaR model captures non-linear risk. Steps should also be taken to ensure that adequate capital is set aside for any other risks not captured by the model. *Firms* are reminded that, under 42G, the standard *PRR* rules may instead be applied to these risks.
 - (6) Correlations within and between the risk factors in (1) to (4) may be used provided the system for measuring these correlations is sound and implemented with integrity.

SPECIFIC RISK

- 44 G Where a *firm* wishes to use a VaR model in relation to specific risk it should meet the following additional standards:

- (1) The model on which the VaR estimate is based should explain the price variation in the portfolio. For example, the VaR model may be based on a factor model or on a historical simulation model. The ability of the model to explain price variation could be demonstrated by a statistical comparison over the same period of time between actual price changes on the portfolio and the profit and loss impact of risk factors included within the model. A *firm* may wish to include an estimate of residual variation not explained by the model.
 - (2) The VaR model should be sensitive to changes in the level of concentration risk in the portfolio.
 - (3) The VaR model should be robust to an adverse environment.
 - (4) Where a *firm* calculates its specific risk surcharge under 78G(2) it should conduct specific risk backtesting for the traded debt portfolio and the *equity* portfolio separately. Specific risk backtesting is a comparison of the specific risk VaR measures against the corresponding actual P&L for sub-portfolios that contain material specific risk.
 - (5) The VaR model should be validated through empirical testing appropriate to the level of complexity and the assumptions made in the VaR model, which should be aimed at assessing whether specific risk is being adequately captured. Where specific risk is identified by examining relevant sub-portfolios, then these should be chosen in a consistent manner.
- 45 G A *firm* should have means to assess and, if necessary, mitigate or control event risk. For example, possible means include stress-testing procedures, or reserving policies. It is not however necessary to include factors to model event risk within a specific risk model unless warranted by the nature of the portfolio.

Stress testing and backtesting

STRESS TESTING

- 46 G Stress testing should involve identifying market scenarios or other low probability events in all types of risks that generate the greatest losses on a *firm's* portfolio.
- 47 G A *firm* should periodically and actively identify all the worst case scenarios that are relevant to its portfolio. Scenarios used should be appropriate to test the effect of adverse movements in market volatilities and correlations and the effect of any change in the assumptions underlying the VaR model. Scenarios involving low probability market events should nevertheless be plausible.
- 48 G A *firm* should have procedures to assess and respond to the results produced from stress testing. In particular, stress testing results should be:
- (1) used to evaluate its capacity to absorb such losses or identify steps to be taken to reduce risk.
 - (2) communicated routinely to senior management and periodically to the directors.

- 49 G Stress testing should capture non-linear effects.
- 50 G A *firm* should have the capacity to run daily stress tests. A *firm* may want to conduct the more complex stress tests at longer intervals or on an ad hoc basis.

BACKTESTING

- 51 G Backtesting is the process of comparing VaR risk measures to portfolio performance. It is intended to act as one of the mechanisms for the ongoing validation of a *firm's* VaR model and to provide incentives for *firms* to improve their VaR measures.
- 52 G Backtesting is only one method of assessing the performance of a VaR model and, although *firms* are required to carry out a backtesting programme, they should adopt other methods of measuring performance as well.
- 53 G Before a *waiver* will be granted to use a VaR model, a *firm* should have a backtesting programme in place and should provide three months of backtesting history.
- 54 G A *firm* should have the capacity to analyse its daily profit and loss account and compare the results to the VaR measure used for backtesting, both at the level of the whole portfolio covered by the VaR model and at the level of individual books that contribute material amounts to risk or the profit and loss account.
- 55 G VaR models are likely to undergo almost continuous refinements. This may make it difficult to backtest using 250 days' data if it is based upon a previous version of the model. If a refinement is not regarded as material, then a *firm* may use the last 250 days' data for backtesting purposes.
- 56 G A *firm* should compare each of its 250 most recent *business days'* profit and loss account figures with the corresponding one-day VaR measures. This comparison should be made daily using a rolling 250-day period.
- 57 G The VaR measure used for backtesting for these purposes should be calibrated to a one-day holding period and a 99% one-tailed confidence level, but otherwise the VaR model should be the same as that used to calculate the VaR model based *PRR*.
- 58 G The positions underlying the profit and loss account and VaR measures should not be materially different.
- 59 G If a *firm* uses a combination of the standard rules (and, where appropriate, CAD1 model) and VaR model approaches or does not model specific risk it should take appropriate steps periodically to ensure that this is taken into account in its backtesting procedures.
- 60 G An exception occurs each time a day's loss exceeds the corresponding VaR measure (at *firm* level). When an exception occurs, a *firm* should notify its supervisor by close of business two *business days* after the exception occurs (oral notification is acceptable).

- 61 G On a monthly basis, a *firm* should submit to the *FSA* a written account of the previous month's exceptions. The written account should include the cause of the exceptions and the *firm's* planned response. Nil returns will not be required.
- 62 G Where multiple exceptions occur, the multiplication factor used by a *firm* in its VaR model based *PRR* calculation should be increased by the appropriate plus factor set out in Table 63G (details of how the multiplication factor affects a *firm's* VaR model based *PRR* are set out in the Calculation of a VaR model based *PRR* section of this appendix). The table sets out the plus factor to be applied given the number of exceptions over the most recent 250 *business days*.
- 63 G Table: backtesting plus factors (see 62G)

Green	Fewer than 5	0.00
Yellow	5	0.40
	6	0.50
	7	0.65
	8	0.75
	9	0.85
Red	10	1.00

- 64 G The addition of a plus factor for VaR models that appear to be under-performing is designed to act as an incentive to ensure that the VaR model continues to perform well, and where it does not, that a *firm* takes prompt action to remedy the situation.
- 65 G If ten or more exceptions are recorded in a 250 day period, the *firm* should to take immediate corrective action. In these circumstances, the *FSA* may apply a plus factor greater than one, or the *FSA* may consider revoking a *firm's* VaR model *waiver*, unless it is varied in accordance with section 148 of the *Act*.
- 66 G If ten or more exceptions are recorded in a 250 day period due to the specific risk backtesting required in 44(4)G then the *firm* should take immediate corrective action on the specific risk part of the model or set aside additional capital.
- 67 G If a *firm* believes an exception should be disregarded it should submit to the *FSA* a written explanation of why the exception occurred and why it would be appropriate to disregard it. An exception may be disregarded only in exceptional situations. One example of when an exception might properly be disregarded is when it has arisen as a result of a risk that is not captured in its VaR model but against which regulatory capital is already held.

- 68 G The *FSA* may also consider disregarding a backtesting exception where, in a period of high volatility, multiple backtesting exceptions occur before the data set is updated.
- 69 G During the first 250 days after a *firm* starts to use its VaR model to calculate its VaR model based *PRR* the policy in 62G relating to plus factors only applies to the period from the date that VaR model recognition is granted.

DEFINITION OF PROFIT AND LOSS ACCOUNT FOR BACKTESTING PURPOSES

- 70 G Backtesting should be performed using a measure of actual profit and loss.
- 71 G Actual profit and loss means the day's profit and loss account arising from the trading activities within the scope of the VaR model. This should exclude material non-market elements which might mask a loss. Such elements include *fees* and *commissions*, reserving which is not directly related to market risk and one-off marketing profits from new deals.
- 72 G Actual profit and loss should reflect any price adjustments arising from position reconciliation in accordance with a *firm's* written policies and procedures. These policies and procedures should include a documented method of assigning valuation adjustments to backtesting data, such that the amount and the date of adjustment is unambiguous.
- 73 G A *firm* should have the capacity to perform backtesting against hypothetical profit and loss. The *FSA* may require firms to produce this information upon request. Hypothetical profit and loss means profit and loss that would have occurred had the portfolio remained unchanged.
- 74 G VaR models are likely to undergo almost continuous refinements. This may make it difficult to backtest using 250 days' data if it is based upon a previous version of the model. If a refinement is regarded as material then a new *waiver* may be required to use a VaR model and the original *waiver* may be revoked (as set out in 28G). If a refinement is not material then a *firm* may use the last 250 days' data for backtesting purposes.

Calculation of VaR model based *PRR*

- 75 G The calculation of a *PRR* under the VaR model approach is set out in this section. A *firm* will be required by the *waiver* to add its VaR model based *PRR* to its other *PRRs* calculated under 10-80(2)R.
- 76 G A *firm's* VaR model based *PRR* on a daily basis is equal to the higher of:
- (1) its previous day's VaR number; and
 - (2) the average of its daily VaR measures on each of the preceding sixty *business days* multiplied by a multiplication factor (increased by the appropriate plus factor referred to in 63G).

- 77 G The multiplication factor to be used is specified by the *FSA* in the formal VaR model *waiver* direction as a condition of its use. The minimum multiplication factor that the *FSA* will set is 3, although a higher multiplication factor may be applied. This multiplication factor is the factor that should be used, unless the *waiver* has been varied in relation to this factor in accordance with Section 148 of the *Act*.

G The following equation expresses 76G and 77G mathematically:

$$PRR_{VaR} = \text{Max} \left(VaR_t, f \times \frac{1}{60} \sum_{i=0}^{59} VaR_{t-i} \right) + SR$$

PRR_{VaR} is a *firm's* VaR model based *PRR*;

VaR_t represents the previous day's VaR figure;

VaR_{t-i} represents the VaR calculated for *i business days* earlier;

f is the multiplication factor referred to in 76(2)G and 77G;

SR is the specific risk surcharge which is only included in the calculation set out 78G where a *firm* has been granted a VaR model *waiver* in relation to specific risk. Details on the specific risk surcharge can be found in 79G to 80G.

- 78 G If the VaR model *waiver* granted enables a *firm* to calculate a specific risk *PRR* by the use of its VaR model then it should calculate its specific risk surcharge as either:

- (1) an amount equal to the specific risk portion of the VaR measure; or
- (2) an amount equal to the VaR measure of sub- portfolios that are subject to specific risk.

In both cases, the specific risk surcharge should be calculated as an average over the previous 60 *business days*.

- 79 G Where a *firm* calculates its specific risk surcharge using 78(1)G, then it should calculate specific risk for the purposes of calculating the surcharge as the difference between total value at risk and a measure of general market risk. In calculating general market risk for this purpose, positions that give rise to specific risk should be mapped to equivalent positions that bear general market risk only. In doing so, the following minimum standards should be adopted:

- (1) For *equities*, each position should be mapped to a factor that is representative of the national or international market to which they belong. For example, a stock may be mapped to a widely accepted broadly based stock market index for the country concerned.
- (2) For bonds, each position should be mapped using a reference interest rate curve for the currency concerned. The interest rate curves should be generally accepted by the market as broadly based reference curves for the currency concerned, for example, a government bond curve or a swap curve.

- 80 G Where a *firm* calculates its specific risk surcharge using 78(2)G, then the sub-portfolio structure should be identified in advance and any changes to the structure should be pre-notified to *FSA*. The sub-portfolios chosen should be those which contain positions that would produce a specific risk *PRR* under the standard rules approach

Appendix 20

GUIDANCE NOTES ON RECONCILIATION OF FIRM'S BALANCES WITH A COUNTERPARTY WHICH IS A MEMBER OF AN EXCHANGE

(rule 10-11(4))

Introduction

- 1 The purpose of this guidance is to state how under rule 10-11(4) the reconciliation process with counterparties which are also members of exchanges should be performed.

Scope

- 2 The reconciliation to be performed with counterparties should cover all outstanding balances and *securities* positions with such counterparties from all sources except to the extent that the components of such balances and *securities* positions have been agreed by other means. Agreement by other means shall include (but is not to be limited to) those which have been—
 - (a) matched or cleared through an exchange, clearing house or clearing system; or
 - (b) verified by dispatch to or receipt from the counterparty of a confirmation or statement. Such verification should have been evidenced in writing or by electronic media.
- 3 The reconciliation should cover all remaining outstanding items including, for example, fee-based items, dividends where these are on the *firm's* balance sheet, coupons, amounts arising under *OTC* contracts, *repurchase* and *reverse repurchase agreements* and *securities* lending and borrowing.
- 4 The items to be included should be all those past trade date which is consistent with *trade date accounting*.
- 5 Where necessary a *firm* should initially circularise a list of all relevant open items as set out above rather than a net balance. A *firm* should identify the assumptions made by them in ascertaining which balances (or types of balances) have been included in the reconciliation. A *firm* should also identify where the balances or *securities* positions with a counterparty arise from different accounts operated by them with that counterparty.
- 6 The scope of the rule is intended to cover nil balances although these may be covered on a sample basis only. They are included because discrepancies in such balances may only come to light as being incorrectly stated on the performance of a circularisation. However, reconciliations of nil balances do not need to be performed where—

- (a) the counterparty is also a *firm*; or
- (b) there has been no outstanding balance with the counterparty at any point during the year.

Timing

- 7 It is considered preferable for a *firm* to be aware in advance at which periods of the year they will receive reconciliations requests. This may be of use to a *firm* in enabling it to plan in advance the allocation of staff for the performance of the reconciliations. Thus, it is suggested that a *firm* submits such circularisations, where possible, at calendar quarter end dates. It is considered that, in any case, the majority of *firms* would be likely to circularise such statements at these dates. However, a *firm* will be eligible to circularise at other dates as, for example, when its own *annual* or *quarterly accounting reference dates* do not coincide with the calendar quarter end.
- 8 A *firm* may perform the reconciliation in conjunction with the work undertaken by its auditors for the purposes of the annual audit.

The obligation on firms

- 9 Where a *firm* receives a statement from a *counterparty* during the year, the recipient *firm* is not also required by virtue of rule 10-11(4) to send a further statement to that counterparty in the same year.
- 10 A recipient of a circularisation request from another *firm* must use its best endeavours to respond. Notwithstanding paragraphs 7 and 8 above, this obligation will apply even if this request is received more frequently than once a year from the same counterparty or is wider in scope than required by paragraphs 2 to 6 above (for example, by also covering balances which have already been agreed by other means). Rule 10-11 only requires that specific balances be covered. This is intended as a minimum requirement and not necessarily as the norm. If a *firm* need not reply to a request more than once a year or which covered balances of a wider scope, *firms* would be discouraged from requesting such reconciliations.
- 11 Rule 10-11(6) requires a *firm* to respond, within one month of receipt, to a circularisation request received from another *firm*. The one month response period should also be observed in relation to circularisation requests received under rule 10-11(4).
- 12 It is not considered necessary to issue detailed guidance for the procedure to be adopted in cases where the recipient does not reply to a circularisation request sent by a *firm*. It is intended that a *firm* need only take reasonable steps to obtain any such reply. However, before a *firm* has taken such steps, it should not assume that the circularisation is agreed merely due to the absence of a reply from the counterparts.

Appendix 21

NOTES ON THE VALUATION OF POSITIONS

(rule 10-41(9))

Introduction

- 1 Rule 10-41(9) states that a position must be valued at its close out price, where close out price means that a long position should be valued at current bid price and a short position at current offer price. In addition, rule 10-41(9) states that a *firm* must value a position on a prudent and consistent basis, and have regard to the liquidity of the instrument concerned and any special factors that may adversely affect the closure of the position.
- 2 The following paragraphs give general indications to *firms* on the appropriate valuation methodology. However, it is emphasised that prudence should be the overriding influence in the valuation exercise and that, where uncertainty exists as to the most appropriate price, the *firm* should use that price which gives the most conservative valuation.

General principles

- 3 *Firms* should value positions by reference to market prices, but where necessary should add a prudent and appropriate buffer to the bid or offer price to account for factors which would adversely affect the *firm's* ability to realise the close-out value, such as -
 - (a) the liquidity of the *security* in question;
 - (b) the size of the position held in that *security* relative to the sizes at which prices are quoted;
 - (c) the direction of the position (long or short) relative to the current direction of the market;
 - (d) the exposure of the *firm* to the relevant market as a whole;
 - (e) any conversion or foreign exchange costs that would be incurred if the position were closed out;
 - (f) any other factors which may affect the close-out price.
- 4 Where a mid-market or single price only is available for the *security* in question, *firms* must adjust this price by a prudent and appropriate buffer as outlined in paragraph 3 above.
- 5 With respect to paragraphs 3 and 4 above, *firms* should be able to demonstrate at all times how they determined the final price applied to any position in a *security*.

Appendix 34

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Appendix 35

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Appendix 43

GUIDANCE NOTES ON THE FINANCIAL RESOURCES AND ACCOUNTING TREATMENT OF SOFT COMMISSION AGREEMENTS

(rules 10-73 and 10-175)

1 Introduction

This Appendix contains detailed guidance to the following rules–

Rules	
10-73	Expenditure requirement
10-175	CRR on other amount owed to a <i>firm</i> arising out of <i>trading book</i> business.

2 The FSA is of the view that it is not responsible for setting accounting policies in relation to a *firm's audited annual financial statements*. However, the FSA considers that it is preferable for all *firms* participating in "soft commission agreements" to have consistent accounting policies. Without such consistency, certain *firms* would have a competitive advantage in terms of their *financial resources*. Therefore, for the purposes of completing *financial reporting statement* submitted to the FSA, appropriate accounting policies should be used. The guidance and interpretations made in this Appendix should be considered in this context.

3 The guidance applies to all *firms* which participate in "soft commission agreements" whether or not this is the sole *investment business* of the *firm*.

4 Definition

A soft commission agreement means–

"any agreement, whether oral or written, under which a *firm* which deals in *securities* on an advisory basis, or in the exercise of discretion, receives goods or services in return for an assurance that not less than a certain amount of such business will be put through or in the way of another person;"

5 Description

A "soft commission agreement" is understood as being one in which a fund manager agrees, either formally or informally, to provide a broker with a certain amount of commission in any one period in return for the provision of services

"free". Those services may be provided in-house or by third parties and may take the form of specific research provided by analysts, portfolio valuation systems, or information packages, plus the associated computer hardware and software.

- 6 Under traditional broking arrangements, the full service broker normally receives commission in return for the total servicing of a fund manager's account, a package which includes execution, perhaps custodianship and, almost certainly, research, also "free". The services provided under traditional broking arrangements are in-house i.e. within a broking group, and mostly are not conditional upon receipt by the broker of a certain level of commission, although there is usually an understanding which may never be articulated, that a certain volume of business will be generated.

7 Existing difference in accounting policies

The accounting policies used can in general be divided into those which are "profit & loss" based and those which are "balance sheet" based. Under the former, the *firm* will write-off such expenditure to its profit & loss account but will usually not accrue a liability in its *financial reporting statements* for commissions received in advance. Consequently, the "normal" profit & loss based accounting systems for expenses incurred and commissions received will be used. It should be noted that such *firms*, as they are fundamentally participating in traditional broking arrangements, may not have legally enforceable "soft commission agreements" with their counterparties, such that there may be no absolute contractual liability on the *firm* or counterparty to provide expenditure or commission.

- 8 *Firms* using the "balance sheet" approach will accrue for liabilities but will also tend to capitalise their expenditure under "soft commission agreements". This may be the policy used by *firms* which specialise in legally enforceable "soft commission agreements" and reflects the legal status of such agreements. These may contract the counterparty to pay a level of commission related to the level of expenditure incurred by the *firm* (and vice versa if the counterparty has paid advance commission in excess of the expenditure paid by the *firm*).

9 Expenditure and balances receivable

Once expenditure is incurred for a counterparty, the soft commission broker may claim that contractually the counterparty is bound to pay him a certain multiple of that expenditure in the form of commission within a certain period of time from the date the expenditure was incurred. Consequently, certain *firms* have previously capitalised their expenditure and shown it as an asset for the purposes of calculating their *financial resources*.

10 Required treatment

Where a *firm* incurs expenditure on behalf of a counterparty or counterparties in respect of "soft commission agreements" (whether or not it is incurred in relation to a written contract), the *firm* should immediately write off such expenditure to its profit & loss account.

- 11 Notwithstanding the above, expenditure may be capitalised (as an asset) in the balance sheet of the company which incurred the expenditure, **only where this amount is recoverable under a legally enforceable contract** (see paragraph 18 below). Where such expenditure is capitalised it will be subject to rule 10-175.

12 Income and balances payable

Once commission income is received from a counterparty, the *firm* may recognise that contractually it is bound to pay the counterparty a certain proportion of that income, in the form of the counterparty's expenses, within a certain period. Although certain *firms* are including this amount as a liability on their balance sheet (and thus reducing their *financial resources*), other *firms* are making no such provision.

13 Required treatment

Where a *firm* has a contractual liability to, or on behalf of, a counterparty or counterparties which arises from a legally enforceable "soft commission agreement", the *firm* should accrue in its *financial reporting statements* a liability for the relevant proportion of any advanced commission income received from the counterparty that will have to be subsequently incurred as an expense by the *firm* in the form of a payment on behalf of the counterparty for allowable goods and services.

14 Expenditure requirement

Once expenditure is incurred for a counterparty, the soft commission broker may claim that contractually the counterparty is bound to pay him a certain multiple of that expenditure in the form of commission within a certain period and thus such expenditure should not be included in the *firm's* expenditure requirement.

15 Required treatment

Expenditure incurred by soft commission brokers should be included in a *firm's* expenditure requirement, unless it is incurred under a legally enforceable "soft commission agreement" when it may be excluded from the expenditure requirement calculation.

- 16 The reasoning behind this treatment is that the expenditure of a *firm* participating in soft commission arrangements is similar to shared commissions and can,

therefore, be treated as though it were shared commissions under rule 10-73(2)(f), except to the extent that such expenses are irrecoverable, i.e. except where there is no enforceable legal agreement.

17 It is considered that certain *firms* may have been under the misapprehension that there was a concession for all expenditure related to "soft commission agreements" regardless of whether the agreement was legally enforceable. Where a *firm* undertakes a mixture of business between legally enforceable contracts and informal arrangements (all of which the *firm* would classify as "soft commission agreements"), it must take great care in allocating expenditure between legally enforceable contracts and others. Alternatively, it may decide to include all expenditure in the expenditure requirement regardless of source.

18 Legally enforceable contracts

For the purposes of this guidance, for a "soft commission agreement" to be legally enforceable there should be a specific written legal contract governing the arrangements. The contract should be legally enforceable by the *firm* involved, both in the UK and in any other relevant country.

Appendix 47

Counterparty Weights To Be Applied In Calculating Liquidity Adjustment And CRR

(rules 10-64 to 10-68, and 10-172 to 10-176)

This Appendix details the appropriate *counterparty* weights to be applied when calculating a liquidity adjustment in accordance with rules 10-64, 10-65 and 10-66, a requirement on a charged asset in accordance with rule 10-67 or a requirement on a *contingent liability* in accordance with rule 10-68 and the *CRR* percentages applicable in the calculation of a *firm's CRR* in accordance with rules 10-172 to 10-176.

Type of counterparty	Counterparty weight
claims on, or explicitly guaranteed by, or collateralised with <i>securities</i> issued by: <ul style="list-style-type: none"> - the central government or central bank of a <i>Zone A</i> country; - the <i>European Communities</i>; or - any other government or central bank, provided the <i>exposure</i> is denominated in that country's national currency. 	NIL
claims on discount houses, gilt-edged <i>market makers</i> , institutions with a <i>money</i> market dealing relationship with the Bank of England and those <i>Stock Exchange money brokers</i> which operate in the gilt-edged market, where the claims are secured on gilts, UK Treasury bills, eligible <i>local</i> authority and eligible bank bills, or London CDs	10%
claims on, or explicitly guaranteed by: <ul style="list-style-type: none"> - a <i>multilateral development bank</i>; - the regional government or <i>local</i> authority of a <i>Zone A</i> country; - a <i>Zone A credit institution</i>; - a <i>recognised clearing house</i> or <i>recognised exchange</i>; - a recognised third country or <i>EEA investment firm</i>; - a <i>Zone B credit institution</i>, provided the <i>exposure</i> has a maturity of one year or less. 	20%
any other <i>counterparty</i>	100%

Guidance

The guarantee should be explicit and be legally enforceable by the *firm* and should prevent a *firm's* capital from becoming deficient as a result of experiencing a loss on such an exposure. The exposure must be retained on the *firm's* balance sheet.

Appendix 48

SECURITIES AND FUTURES FIRMS: GUIDANCE NOTES ON THE SECONDARY REQUIREMENT

1. Illiquid assets

As set out in rule 10-74, firms are required to calculate a secondary requirement on illiquid assets in certain circumstances.

The *FSA* may consider lowering the level of this part of the secondary requirement in steps, if a *firm* can demonstrate, for example:

- (a) that the fixed assets concerned are readily realisable or can be used as *collateral* against which additional liquid funds can be raised; and
- (b) that the risks arising from its loans are well diversified, are partially or fully secured to the *FSA's* satisfaction, or loans are granted only in accordance with formal credit assessment procedures.

Other factors which the *FSA* may take into account will include:

- (a) whether the assets are core to the firm's ongoing business and therefore their ready realisation will be inhibited;
- (b) the relationship between the balance sheet value and market value of the assets;
- (c) the nature of *counterparties* concerned where relevant;
- (d) the number of individual *illiquid assets* greater in value than 10% of *initial capital* plus interim year's profit and loss; and the size of the excess of total *illiquid assets* over 25% of *initial capital* plus interim profit and loss.

2. Discretionary secondary requirement

A firm may be required to include at the *FSA's* discretion (by the imposition of a *requirement*) a secondary requirement as part of its financial resources requirement. In setting a secondary requirement, the *FSA* will take into account whether a firm meets the following criteria.

Liquidity management

The *FSA* will consider whether a *firm* can demonstrate that it has procedures to manage its current and future cashflows and capital requirements and planned routes to obtain additional capital.

The factors which the *FSA* may take into account the following when evaluating a *firm's* ability to satisfy this criterion include:

- (a) the frequency and detail with which cashflow forecasting is performed;
- (b) the ability to monitor the mismatch of cashflows, in particular the effect of individual transactions on a *firm's* liquidity;
- (c) the availability of banking facilities;
- (d) the existence of excess capital in *group* companies or the financial standing of the *firm's controllers* or both; and
- (e) the *firm's* gearing ratio.

Management

A *firm* must be able to demonstrate that, given the nature and size of its business, effective management control is exercised.

In considering this criterion, the factors that the *FSA* may take into account include:

- (a) the level of product awareness and managerial experience of senior management;
- (b) the number and location of senior managers in the context of the type and size of *firm*;
- (c) where appropriate, the independence of senior management, including the possible existence of an internal audit function;
- (d) the extent to which senior management monitors and controls the day to day activities of the *firm* including, for example, the setting and monitoring of limits governing credit and market exposures;
- (e) the integrity and attitude towards regulation of senior management; and
- (f) the existence of clearly defined business strategy laid down by the *firm's* senior management and the extent to which this has been communicated to the appropriate staff, including, for example, consideration of products, markets, *client* base, staffing and systems.

Systems and control

Taking into account the size of the *firm*, the diversity of its business activities, the volume, size and frequency of transactions and the degree of risk arising therefrom, a *firm* must be able to demonstrate that it has established and maintained effective systems and methods of internal control.

In considering this criterion, the factors that the *FSA* may take into account include:

- (a) the existence of standard operating procedures laid down by management and adhered to by staff governing the way in which businesses are performed, who may commit the *firm*, the methods for recording and processing transactions and the production of management information;
- (b) how frequently these operating procedures are reviewed to ensure that they continue to address the activities of the *firm*;
- (c) the existence of risk management systems which, based on the nature, size and complexity of the business, measure the risks incurred in all their activities including market, credit, operational and legal risks and include control mechanisms to alert management where risks become unacceptably high e.g. exception reports;
- (d) whether staff are sufficient in number, have appropriate experience, skill levels and specialised knowledge to manage the risks of processing, reporting and controlling the business undertaken.
- (e) the existence of management information which allows management to determine whether the *firm* is meeting its strategic plans, budget, forecasts etc.
- (f) the degree of centralisation of control procedures and systems;
- (g) the *firm's* commitment to staff training;
- (h) where appropriate, the effective use of an internal audit function;
- (i) the existence of an independent review procedure to assess the risks arising from new and ongoing business activities;
- (j) the frequency of external verification of data held relating to, for example prices, debtors, creditors, balances with depositories and clearing houses;
- (k) the existence of documented systems specifications;
- (l) the existence of adequate and tested back-up facilities and disaster recovery plans;
- (m) the availability of maintenance and programming expertise;
- (n) the age, degree of automation and integration of a *firm's* systems and the ability of a *firm's* systems to process additional data; and
- (o) the existence of insurance cover appropriate to the *firm's* activities.

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Appendix 55

Guidance Notes On The Application Of Adequate Collateral Or Acceptable Collateral To Reduce Counterparty Exposures

Introduction

- 1 The purpose of this note is to give guidance to *firms* on how *collateral* received from *counterparties* may be applied to reduce *exposures* to *counterparties* on which *CRR* and liquidity adjustments are calculated.

Types of collateral

- 2 The *FSA* recognises two different definitions of *collateral*–
 - (a) *acceptable collateral*, which is a fairly limited definition and includes only cash, gold and silver bullion, certificates of deposit issued by and lodged with the *firm*, *securities* issued by *Zone A* central governments, *Zone A* central banks and the *European Communities*; and
 - (b) *adequate collateral*, which is a much broader definition and includes as well as the types of *collateral* listed in (a) above, *shares*, *Talisman short-term certificates*, letters of credit and guarantees.

Status and value of collateral

- 3 In order that a *firm* may rely on collateral to reduce *exposures* to *counterparties*, it must meet certain criteria, i.e. the *firm* must have an unconditional right to apply or realise the *collateral* for the purposes of repaying the *counterparty's* obligations to the *firm*; and in the case of *adequate collateral*, it may not be issued by the *counterparty*. *Collateral* should be accurately valued, in particular collateral in the form of *securities* must be marked to market daily using the same principles as used for valuing positions (rule 10-41).

Application of collateral

- 4 *Acceptable collateral* may be used to reduce an *exposure* arising under any of rules 10-65, 10-66 and 10-170 to 10-176. Any uncovered *exposure* will then be subject to the relevant liquidity adjustment or *CRR* percentage.
- 5 *Adequate collateral* may be applied to *counterparty exposures* in two different ways. If the *counterparty exposure* arises on a transaction subject to rule 10-173 (repurchase and reverse repurchase, *securities* lending and borrowing and *sale and buy back agreements*), only that part of the *exposure* left uncovered will be subject to the relevant *CRR* percentage. If the *counterparty exposure* arises on a transaction, subject to rules 10-172 (*free deliveries of securities*), 10-174 (*derivative transactions*) or 10-175 (other amounts owed to a *firm* arising out of *trading book*

business), the part of the *counterparty exposure* covered by *adequate collateral* will be subject to a maximum 8% *CRR* percentage, while the part of the *counterparty exposure* left uncovered will be subject to the *CRR* percentage detailed in the relevant rule.

Appendix 56

Guide To Adequate Credit Management Policy (ACMP) (rules 10-172 to 10-175, 10-300 and "ACMP")

Introduction

- 1 This appendix contains general guidance on the standards which the *FSA* expects a *firm's ACMP* to meet.

Objective

- 2 The *FSA's* objective is to ensure that adequate procedures and controls are in place to manage effectively the granting of credit and the monitoring and controlling of credit risk.

Scope

- 3 The guidance applies to any *firm* which wishes to:
 - (a) take advantage of the lower *CRR* percentages (by which counterparty exposures must be multiplied); and
 - (b) have its *ACMP* taken into account in the determination of the appropriate level of its secondary requirement.
- 4 Before a firm may use the lower percentages in calculating *CRR* and in preparing its financial reporting statements, it must meet the requirements set by 10-300. The *ACMP* and its operation will be reviewed periodically by the *FSA* and, where it is no longer operating effectively, the firm may be in breach of those requirements.

Background

- 5 The *FSA* is aware that *firms* grant credit to counterparties in many different ways, including for example, loans to cover actual margin calls as a result of delays between trade date and final settlement or of late settlement etc. This guidance is designed to cover all instances where a *firm* becomes exposed to credit risk although, depending on the way in which credit risk arises, the procedures for managing it may differ.
- 6 In considering the credit management policies of a *firm*, the *FSA* will expect the *firm* to operate a robust control structure which is appropriate to the size, scale and nature of its business and the diversity and complexity of its exposures. The *FSA* recognises that different approaches to and styles of credit management can create an effective operational control environment. Therefore, it is not appropriate for the *FSA* to lay down prescriptive standards which it would expect a *firm* to meet, but rather to suggest a broad framework which is flexible, allows for individualised solutions and can accommodate and encourage evolutionary developments.

- 7 The prime components of a sound credit risk management process are:
- the definition by a *firm* of what constitutes a credit exposure/risk and is therefore covered by the *firm's ACMP*;
 - a comprehensive credit risk measurement approach;
 - the existence of guidelines and other parameters used to determine credit limits and govern the level and types of risk taken; together with
 - a strong management information system for controlling, monitoring and reporting exposures.

Thus, when the *FSA* reviews a *firm's* credit management process, it will seek comfort that credit exposures are managed and controlled in a highly disciplined manner and that the relevant staff are well versed in the *firm's* credit procedures.

- 8 Where a *firm's* credit risk management is controlled or overseen by its parent or an affiliate in the same group, provided that the *firm* can identify reasonable grounds for believing that the level of control is suitable, this should not impede use of the *firm's ACMP*.

General principles

- 9 In forming its view as to the adequacy of a *firm's* credit risk management process, the general characteristics which the *FSA* may take into account include the following:

Role of senior management

- (a) whether the framework of credit risk management, i.e. a *firm's* policies and procedures, is overseen by the board of directors or an equivalent management body;

Procedures

- (b) whether there are clearly established lines of responsibility and levels of authority for:
- the granting of credit to a counterparty;
 - extending its permitted use to cover risk arising on a product new to the counterparty;
 - increasing existing credit facilities; and
 - the monitoring and controlling of all credit risk;

- (c) the extent to which the functions of granting, measuring, monitoring and controlling credit risk are managed independently of the front office with a direct reporting line to the senior management ultimately responsible for credit risk management;
- (d) whether good channels of communication exist which ensure that the *firm's* credit management procedures are well understood and followed by all relevant personnel;
- (e) whether procedures exist for identifying unintentional credit exposures and dealing with counterparty which has failed to settle its obligations to the *firm*, (whether merely due to a delay or actual default), or which is expected not to settle its obligations on the due date; including arrangements for closing out transactions. In addition, the *FSA* may consider whether a *firm* has the ability to identify and attempt to predict, as well as quantify, any shortfall as it arises and on an aged basis;
- (f) whether mechanisms exist for a daily comparison of exposures with credit limits, including the production of exception reports, and the procedures to be followed to deal with the results of those exception reports;

Documentation

- (g) whether a *firm's* credit management policies and procedures are properly documented and reviewed by the *firm* on a regular and thorough basis to ensure that they continue to remain appropriate and sound;
- (h) whether records are kept in respect of each counterparty (identified on an individual legal entity basis) indicating in sufficient detail, the level of credit risk to a counterparty to which the *firm* is willing to expose itself. Where a *firm* grants a credit facility similar to a loan to cover, for example, margin calls, such records might give details of the credit facility extended to a counterparty together with any information gathered in support of the decision to grant that credit facility, the types of transaction which the *firm* may enter into with the counterparty and to which the credit facility may be allocated. Credit information relating to counterparties should be regularly updated and reviewed by the *firm* to ensure that any credit facility granted remains appropriate;

Collateral and margin

- (i) whether the *firm* has written policies relating to the margining and collateral arrangements with its counterparties. Terms of business or customer agreements would normally detail the circumstances when margin might be called, and the type and level of collateral which would be acceptable to the *firm* on the basis of its liquidity, volatility and ability to be realised. In addition, it may be relevant to consider the degree to which a *firm's* collateral records

are kept up to date and include details of the practical procedures for the realisation of such collateral.

Measurement and monitoring of exposures

- (j) whether a *firm* has mechanisms for identifying the level of concentration of credit risk exposures to each individual counterparty, and each group of connected counterparties, etc on a regular and timely basis;
- (k) where a *firm* uses risk reduction techniques (such as master agreements, netting agreements, collateralisation arrangements or the taking of third party credit enhancements, including letters of credit and guarantees), whether the firm has procedures for scrutinising documents and assessing their impact on the credit risk of the *firm* and assessing the quality of any guarantees or letters of credit;
- (l) depending on the nature of the credit exposures to which a *firm* is subject, whether the *firm's* mechanisms for measuring such exposures are appropriate to cover the type or level of risk to which they give rise.

Additional Guidance on the FSA's Assessment of ACMPs

Preamble

This document is intended as a guide to those areas of Credit Management Policies which the FSA will address when considering their adequacy.

A definition of credit and the measurement of credit risk

The FSA expects that *firms* have a clear definition of what is considered to be “credit risk” (by whatever name it is known) within the *firm*.

The FSA expects *firms* to consider in depth the measurement of the extent of Credit Risk which is incurred vis a vis any given counterparty. *Firms* should be aware that the extent of credit risk incurred will not necessarily be the same as the nominal value of contracts entered into (“value at risk” concept).

The FSA will expect that firms measure and monitor the extent of Credit Risk incurred vis a vis any given counterparty by reference to a system of limits showing the maximum Credit Risk which the *firm* considers it prudent to incur vis a vis that counterparty having regard for the financial strength of the counterparty.

The FSA expects there to be adequate procedures within the *firm* for the recognition of where credit risk may be incurred, for the approval of incurring such risk, and, once incurred, for the monitoring of that risk to ensure the satisfactory recovery of all amounts owed to the *firm* by a counterparty.

The decision to grant credit

If there is a formal decision making body (e.g. a “Credit Committee”) which reviews applications for credit:

- How does it derive its authority?
- What is the extent of any Credit Committee’s authority as regards:
 - amount of credit granted
 - tenor of credit granted
 - products for which credit lines may be approved
 - industry sectors for which credit lines may be approved?
- How is any Credit Committee constituted?

- What are the qualifications of any Credit Committee’s members to make the decisions required of them?
- Independence of Committee from profit centres
- Recording of Approvals

If there is no formal committee, what procedures exist to ensure adequate collective responsibility for credit decisions giving regard for the duality (“four eyes”) principle and independence of decisions made from profit centres likely to benefit from income? e.g.

- “round robin” circulation of papers to Directors/Credit Management
- individual sign off on each transaction/deal

Many of the comments noted above concerning a “Credit Committee” will be relevant also where no formal Committee meets, as will the following remarks concerning the documentation provided to those making credit decisions.

What documentation is provided to those charged with reaching decision to grant credit?

Cover sheet detailing proposed credit.

- Name of proposed counterparty (identify correct legal entity)
- Address of proposed counterparty
- Amount of credit
- Currency of credit
- Tenor of credit
- Collateral/Security proposed (where applicable)
- Remuneration for credit granted
- Products
- Existing exposure to counterparty (in case of increase/review)
- Previous payment performance of counterparty (in case of increase/review)

Financial information on proposed counterparty.

In order to ascertain the financial strengths and weaknesses of a proposed counterparty The FSA expects *firms* to revert to financial information, some examples of which are given below.

- Annual report and accounts
- Analysis of annual reports and accounts
- Credit reference agency reports e.g. Dun and Bradstreet
- Rating agency reports e.g. Standard and Poors, Moody's
- Brokers reports
- Bank status reports
- Statements of net worth

“Credit memorandum” or other internally produced paper outlining the reason for proposing the granting of credit to the counterparty.

Some areas which might be covered by such a memorandum are as follows:

- Background information on relationship with proposed counterparty
- Commentary/analysis of financial information
- Future prospects (for profitability, growth etc.)
- Reason for present proposal
- What benefit will it bring to a *firm's* relationship with company?
- Perceived risks in providing the credit proposed
- What measures have been taken to mitigate these risks?
- Provision of management accounts
- imposition of financial covenants
- Taking of security
- Comments on the collateral or security to be taken
- Comments on legal documentation to be employed
- Industry exposure
- Country exposure
- Spread of counterparties - large exposures

The monitoring of credit exposure

Once a proposal to grant credit has been approved The *FSA* will expect that there are adequate procedures in place to ensure the proper monitoring of all credit exposures entered into.

The *FSA* expects the monitoring function to be separate from and managed independently of those profit centres which may benefit from the incurring of credit risk.

In order to ensure adequate monitoring of credit exposure it will be necessary for firms to ensure that decisions concerning credit matters are communicated promptly and efficiently to those who are responsible for their utilisation and monitoring. firms may wish to consider how such matters are communicated to:

- Those entitled to commit the *firm*
- Credit Control Officers
- Senior Management
- Documentation Staff

The *FSA* will consider the methods by which this information is communicated e.g. memorandum, manual lists, credit procedures manuals etc.

Computer systems

Where use is made of computer systems The *FSA* will consider the various methods by which the integrity of databases is ensured. These could include

- Password protection/access rights
- Accuracy/key verification
- Duality principle
- Physical security of systems
- Back up

Where information is transferred between computer systems e.g. for reporting purposes or to PC based systems The *FSA* will consider any reconciliations which are performed.

Reporting

The *FSA* expects there to be an adequate reporting system for the monitoring of credit exposure. Many *firms* make use of a series of reports, analysing their credit exposure

based on a number of different criteria. Examples of the kinds of reports which may be found useful by *firms* are given below.

- Excess reports/Exception reports
- Exposure reports
- by customer/group/connected customers
- by industry
- by country
- Overdue payments reports
- Facilities due for review
- Facilities by collateral/security type
- Collateral/security held
- Large Exposures

The *FSA* will give consideration to the frequency of production of reports used in monitoring credit risk.

Credit Risk Management/Control

The *FSA* will expect to be given details of the action taken where monitoring shows that any aspect of credit exposure is not in line with previously agreed parameters.

For example where exposure is in excess of approved limits The *FSA* will expect to be informed about what action is taken, where payments are not received, how this is followed up. If a counterparty's financial standing deteriorates, what action is taken to attempt to mitigate possible credit loss?

Documentation

The *FSA* expects *firms* to have adequate procedures in place to be certain that all transactions which require documentation are documented and that this occurs within an acceptable time frame, and that any transactions which fail to be documented are identified and reported to Senior Management for appropriate action to be taken.

The *FSA* expects any staff responsible for documentation to be separate from front office/profit centres and have an independent reporting structure. This will ensure that the commercial wish to trade and do business does not cloud the negotiation of effective and binding legal documentation.

- Suitability of documentation to be used
- Preparation of documentation
- Qualification of staff (or choice of solicitors to be instructed)
- Training of documentation staff
- Tenacity of documentation staff

Basic documentation to be obtained from all counterparties might include

- Certificate of incorporation
- Memorandum and articles of association (M&AA)
- Board Resolution

Other documents which a *firm* may wish to call for prior to entering into transactions would include:

- a statement of officers authorised to act for the counterparty and to commit it to transactions
- a list of authorised signatories where one exists
- an audited annual report or interim figures
- credit reference report or bank status report

Other areas for consideration could include:

- Prompt execution of documentation
- Monitoring response to documents sent out
- Chasing where no response

- Reporting missing documentation to senior management
- Proper execution
- Secure storage of documentation
- Regular review of documentation held

Ongoing review of credit risk

The *FSA* expects firms to have in place adequate procedures for the annual (or more frequent) review of credit risk.

- Scope of the review
- Financial information
- Action where concern is raised
- Possible need for more frequent review
- Monitoring of counterparties' performance
- Defaults and delinquent and bad debts
- Provisioning policy

The *FSA* will expect a *firm* to be able to explain what action may be taken as the result of review e.g. reduction of credit limit, calling for further collateral etc. where the review indicates cause for concern.

Documentation of credit policies and procedures and customer files

The *FSA* will expect *firms* to consider the manner in which their Credit Policies are documented. Areas for comment could include:

- Credit Procedures manuals and the context in which they are used
- Internal Board Minutes showing delegated authority
- Credit Committee Minutes
- Operations manuals
- Training material for staff

- Internal memorandum detailing credit policy
- Customer Credit files, to contain
- credit analysis information
- copies of decisions to grant credit
- copies of relevant documentation
- press cuttings
- copies of data input documents

Appendix 57

List Of Exchanges And Clearing Houses Recognised For The Purposes Of IPRU(INV)10

1 Exchanges recognised for the purposes of IPRU(INV)10

- a. *Any recognised investment exchange.*
- b. *Any designated investment exchange.*
- c. *Any regulated market listed in SUP 17 Ann 5C.*

2 Clearing Houses recognised for the purposes of IPRU(INV)10

- a. *Any recognised clearing house as defined in the central Handbook Glossary.*
- b. *Any of the following clearing houses:*

ASX Settlement and Transfer Corporation Pty Ltd (ASTC)
Austrian Kontroll Bank (OKB)
Board of Trade Clearing Corporation
Cassa di Compensazione e Garanzia S.p.A (CCG)
Commodity Clearing Corporation
Emerging Markets Clearing Corporation
FUTOP Clearing Centre (FUTOP Clearing Centralen A/S)
Hong Kong Futures Exchange Clearing Corporation Ltd
Hong Kong Securities Clearing Company Ltd
Kansas City Board of Trade Clearing Corporation
Norwegian Futures & Options Clearing House (Norsk Opsjonsentral A.S. (NOS))
N.V. Nederlandse Liquidatiekas (NLKKAS)
OM Stockholm Exchange
Options Clearing Corporation
Options Clearing House Pty Ltd (OCH)
Sydney Futures Exchange Clearing House (SFECH Ltd)
TNS Clearing Pty Ltd (TNSC)

Appendix 58

VERIFICATION OF INTERIM PROFITS BY EXTERNAL AUDITORS

Introduction

- 1 The purpose of this note is to give guidance to *firms* on the required level of verification of interim profits by external auditors before a *firm* may include such profits in its *initial capital*.

Eligibility for inclusion in initial capital

- 2 Interim profits must have been verified as being fairly stated by an external auditor. The external auditor should normally undertake at least the following -
 - (a) satisfy himself that the figures forming the basis of the interim profits have been properly extracted from the underlying accounting records;
 - (b) review the accounting policies used in calculating the interim profits so as to obtain comfort that they are consistent with those normally adopted by the institution in drawing up its annual financial statements and are in accordance with the principles required under the provisions of the Supervision Manual;
 - (c) perform analytical procedures on the result to date, including comparisons of actual performance to date with budget and with the results of prior period(s);
 - (d) discuss with management the overall performance and financial position of the institution;
 - (e) obtain adequate comfort that the implications of current and prospective litigation, all known claims and commitments, changes in business activities and provisioning for bad and doubtful debts have been properly taken into account in arriving at the interim profits; and
 - (f) follow up problem areas of which the auditors are already aware in the course of auditing the institution's financial statements.

Submission of an interim profits verification report

- 3 (a) A *firm* must submit to the *FSA* a verification report signed by its external auditor which states whether the interim results are fairly stated before it may include the interim profits in its *initial capital*.

- (b) In the normal course of events, wording in the form of a 'negative assurance' will be considered by the *FSA* to be adequate, reflecting the fact that the scope of the verification process is less than that of a full audit of a *firm's* results. However, where the *FSA* has significant prudential concerns about a *firm*, it reserves the right to require an *auditor's report* giving 'positive assurance' before the *firm* may include the interim profits in its *initial capital*.
- (c) A standard form of words for 'negative assurance' purposes is available from the *FSA* on request.

Appendix 59

LIST OF REGULATORS FOR THE PURPOSES OF THE DEFINITION OF RECOGNISED THIRD COUNTRY INVESTMENT FIRMS

Country	Regulator
Australia	Australian Stock Exchange Sydney Futures Exchange
Canada	Alberta Stock Exchange Montreal Exchange Toronto Stock Exchange Vancouver Stock Exchange Investment Dealers Association of Canada
Hong Kong	Hong Kong Monetary Authority Hong Kong Securities and Futures Commission
Japan	Ministry of Finance
Singapore	Monetary Authority of Singapore Stock Exchange of Singapore
South Africa	Bond Exchange of South Africa Johannesburg Stock Exchange South African Futures Exchange
United States	Securities and Exchange Commission Commodity and Futures Trading Commission

Appendix 62

NETTING

Similar Types of Transactions

The rules set out the requirements to be met by firms before offsetting exposures in 'similar types of transactions' with a counterparty (i.e. being those transactions falling under a particular counterparty risk rule). The netting of exposures within a particular rule is to be applied on a first in first out basis.

Derivative Transactions

Firms may offset the negative replacement cost on written OTC options against the positive replacement cost of OTC purchased options with the same counterparty.

Guidance On The Netting Of Counterparty Exposures

Introduction

1. This appendix contains guidance on the requirements to be attained in order for firms to net counterparty exposures assessed under the following areas.

Subject

Cash against documents transactions

Free deliveries of securities

Repurchase and reverse repurchase, securities lending and borrowing and sale and buy back agreements

Derivative transactions

Other amounts owed to a firm arising out of trading book business

Scope

2. The guidance applies to any firm subject to the CRR rules and which takes advantage of the netting provisions contained therein.

Background

3. Agreements which can effect set-off of counterparty exposures exist in two forms:
 - (a) novation agreements (referred as netting by novation) which replace existing contracts with one new contract and therefore can only be used to cover similar transactions with payments in the same currency for the same value dates; and
 - (b) netting agreements which can be used to cover transactions of very different types.

The guidance below applies to both novation agreements and netting agreements.

Principles of Offset

4. Before offsetting exposures in similar types of transactions with a counterparty a firm must have a contractual netting agreement with that counterparty which:
 - (a) covers the transactions which the firm is seeking to net;
 - (b) creates a single obligation in each currency or a single obligation to pay a net sum of cash in the event of default, bankruptcy, liquidation or similar circumstances;
 - (c) does not include a walkaway clause; and
 - (d) is supported by written and reasoned independent legal opinions to the effect that, in the event of a legal challenge, the relevant courts would find the firm's exposure to be the single net amount mentioned in (b) above.

Statement of Law on Netting

5. The prerequisite of holding a netting agreement supported by an independent legal opinion in order to offset exposures is not required where the Financial Law Panel's (November 1993) Statement of Law on netting applies. This Statement of Law indicates that under English law rule 4-90 of the Insolvency Rules 1986 imposes a requirement for complete set-off of transactions between parties incorporated in England and Wales, provided the transactions are mutual (i.e. credits, debts or claims arise from dealings between the same parties and that the parties are acting in the same capacity). Furthermore, it indicates that set-off is mandatory, applies whether or not there is any contractual entitlement to set-off and cannot be excluded by agreement between the parties.
6. As mentioned above mutuality is required in order for there to be complete set-off of transactions. Accordingly, firms are expected to have procedures in place to identify the counterparty and the capacity in which the counterparty is acting. Firms proposing to rely on the Statement of Law on netting must

satisfy themselves of the appropriateness of such reliance and, where in doubt, obtain legal advice. It is important to note that Insolvency Rule 4.90 does not apply to building societies, statutory organisations generally, mutual societies, partnerships and individuals.

Legal Requirements

7. Legal opinions will be needed for the:
 - law of the jurisdiction in which the counterparty is organised;
 - law of the jurisdiction in which any branch involved is located;
 - law that governs the agreement and, if different, the law that governs individual transactions pursuant to it; and
 - law that governs the legal status of the counterparty who is entering into transactions of the type which the firm is seeking to net.
8. Where a firm uses an industry standard agreement which contains netting/set-off clauses the firm may rely only on a legal opinion relating to the netting/set-off clauses in that standard agreement where no amendment has been made to the agreement which would materially affect these clauses and where the legal opinion addresses the capacity of counterparties of the type with which the firm wishes to contract, the contract type and the relevant jurisdictions.
9. Where a netting agreement provides that one or both parties may enter into transactions with each other under the agreement through any of its (or certain designated) branches, then all such branches included in the agreement will be considered to be located in relevant jurisdictions for the purpose of this guidance.
10. Where a netting agreement involves more than one jurisdiction, a legal opinion is required for each to the effect that the agreement creates a single obligation in each currency or a single obligation to pay a net sum of cash in the event of default, bankruptcy, liquidation or similar circumstances.
11. As mentioned above legal opinions should relate to the law of the jurisdiction in which the counterparty is organised (i.e. incorporated or resident). However, certain circumstances may arise where this requirement could be considered not to be applicable; for example where:
 - a firm has no assets or exposure in that jurisdiction;
 - any judgement obtained in that jurisdiction against a firm would not be enforceable under any of the rules in the UK relating to the enforcement of foreign judgements; or

- there are no other factors relating to that jurisdiction which would affect the ability of a firm to make net payments as contemplated by the netting agreement.
12. Where a firm believes that the law of the jurisdiction in which a counterparty is organised is not relevant, that point must be addressed in the legal opinion supporting the netting agreement. The ability to exclude the law of the jurisdiction in which a counterparty is organised does not extend to the netting of those off balance sheet exposures listed in the Solvency Ratio Directive: the amendment to this directive (to permit netting) specifically requires this matter to be addressed in the legal opinion.
 13. It is recognised that, with certain aspects of the agreement, it may not be possible to obtain a definite opinion or that a positive opinion regarding enforceability of the netting agreement can only be obtained subject to certain assumptions and/or qualifications. Where qualifications are made, they should be specific and their effect adequately explained. In the same way, assumptions should be specific, of a factual nature (except in relation to matters subject to the law of a jurisdiction other than that covered by the opinion) and should be explained in the opinion.
 14. Legal opinions on netting agreements must be obtained from independent legal advisers with sufficient expertise and experience in this area of law. Opinions from in-house counsel will not be acceptable. Where the regulator in the jurisdiction of the counterparty is satisfied that the netting agreement is not enforceable under the laws of that jurisdiction, the netting agreement cannot be relied upon regardless of the opinions obtained by a firm.

Compliance with the Legal Requirements

15. It is the responsibility of firms to ensure that the legal requirements set out above are met (firms are to calculate CRR on the gross value of exposures to counterparties where this is not the case). Firms do not need to apply to the FSA in order to net exposures. Similarly, legal opinions on netting agreements and the agreements themselves are not required to be submitted to the FSA for approval. The FSA will establish the existence of legal opinions and netting agreements when compliance with the above requirements is being monitored by its staff.
16. Firms are expected to put procedures in place to ensure that the legal characteristics of netting arrangements are kept under review in light of possible changes in the relevant law.
17. Firms are expected to maintain records demonstrating that, in relation to the legal requirements, the following considerations have been addressed:

- the applicability of the netting agreement to the counterparties, jurisdictions and transactions involved;
- the applicability of the opinions to the counterparties, jurisdictions and transactions involved;
- where more than one jurisdiction is involved, the potential for conflicts in law;
- all documentation is complete and still valid and that the agreement has been properly executed (i.e. that the acceptance of terms have been evidenced);
- the nature and effect of any qualifications in the legal opinions and assessment that these do not impair the obligation to pay a net sum of cash in the event of default, bankruptcy, liquidation or similar circumstances; and
- where an industry standard agreement is used upon which a generic legal opinion has been obtained, identification of those clauses which if altered during the course of negotiating the agreement would affect the right to offset. Internal legal counsel is to evidence review of these agreements to ensure that the effectiveness of the set off clauses has not been altered directly or indirectly by virtue of other clauses being added or deleted.

18. Firms are expected to hold a copy of the legal opinion and the agreement to which it relates.

19. Firms are to net exposures within a particular rule on a FIFO basis. Firms may net only current exposures and cannot net potential future exposures.

Cross-Product Netting

Introduction

The FSA will consider granting rule waivers in order to permit firms to take account of cross-product netting in the calculation of their Counterparty Risk Requirement (CRR) in instances where the FSA regards it appropriate.

The current drafting of the FSA 's Financial Rules for securities and futures firms allows 'similar ' types of transactions to be netted (where those transactions are covered by a valid netting agreement, with a supporting legal opinion). In practice, 'similar ' has been defined as all transactions which fall within a particular CRR Rule treatment. Thus, currently, for the calculation of CRR in relation to exposures to a counterparty which are covered by valid netting arrangements, a firm would be required to assess, for example, a net exposure for all derivative transactions with

that counterparty and a separate net exposure for all repo type transactions with that counterparty.

The FSA will consider granting waivers in accordance with SUP 8, though in general it will expect the following conditions to be met:

1. For the types of transaction which the firm is seeking to net, the firm must have the capability to monitor, and must in practice manage, the resultant exposures on a net basis.
2. All transactions which the firm is seeking to net must be covered by valid netting agreements and supported by legal opinions, in accordance with the requirements of the FSA's Financial Rules; and
3. Where underlying netting agreements are linked by a master netting agreement, the legal opinion must address the enforceability of the netting arrangements in their entirety;

One factor that the FSA will consider in assessing whether a particular applicant meets these requirements is whether the firm has had the use of its ACMP sanctioned for the purposes of calculating CRR.

Appendix 63

GUIDANCE ON CREDIT DERIVATIVES

THIS APPENDIX APPLIES TO FIRMS WHICH TAKE, OR INTEND TO TAKE, POSITIONS IN CREDIT DERIVATIVE PRODUCTS

INTRODUCTION

Over the past few years, there has been an increasing amount of interest and activity in credit derivatives, a class of products that includes credit-linked notes, total return swaps and default options and swaps. For at least some of these products, the commodity being traded is 'pure' credit risk. Through these instruments firms are no longer seeking to contain a risk which is incurred as a by-product of their mainstream

trading activity, but are increasingly moving towards trading that very risk. The FSA requires firms to operate robust internal control systems; the advent of credit derivatives highlights the need for increased vigilance in the assessment, monitoring and control of market risk, credit risk and operational risk. **The primary purpose of this Appendix is to underscore the importance of internal control procedures, particularly in circumstances where firms are trading new risks, or new combinations of risk.** In addition, this Appendix gives some general guidance on capital issues. The non-homogeneity of products under the umbrella term 'credit derivatives' makes it difficult for the FSA to write explicit rules which cover all circumstances. Furthermore, an apparently small change in contract specification might require a significant change in capital treatment. Matters are further complicated by constraints on regulatory capital treatment imposed by European Directives. To date, the FSA has provided guidance to firms on an ad-hoc basis, and it intends to continue with this practice for the time being. That said, the FSA is able to give a flavour of the capital treatments by way of the brief explanations and examples below. This should not, however, be taken as a definitive guide. **Any firm which has positions in credit derivatives, or intends to acquire such positions, should seek advice from the FSA on the capital to be set aside for regulatory purposes.**

INTERNAL CONTROL ISSUES

Most of the risks to which credit derivatives give rise are familiar, as the same types of risk are present in longer-established instruments. However, they may be present in different combinations in new credit products, and this can add challenges to the manner in which risk is measured, monitored and controlled. For this reason it is of particular importance that any firm engaging in credit derivatives, or one which is intending to undertake such activity, considers whether additions or amendments to established procedures and control routines are required in order to capture and monitor the particular combinations of risks inherent in the products they intend to trade.

The following remarks are not intended as an exhaustive review of the matters which firms may need to address in considering the control of their credit derivatives business, but are merely illustrative of some of the issues which are pertinent. While they relate

primarily to credit default type products, many of the considerations will be equally applicable to other credit derivative structures. Firms should also note that procedures for the control of credit derivatives cannot be viewed in isolation: they must mesh seamlessly with the procedures in place for the control of other forms of risk.

New product approval

Before a firm enters into any new type of business, it must ensure that it has in place systems and controls that are adequate to record and monitor the risks of that business. Control issues should be addressed by the firm's senior management, although the level and nature of the controls to be considered during the new product approval process will depend on a variety of factors, including the type and volume of business that will be entered into.

Among the factors which should be considered during the new product process are the following -

- whether the new business falls within the risk appetite of the firm, as established by the Board or equivalent management body;
- an exact description of the type of products to be introduced;
- accounting policies (which firms may wish to discuss with their external auditors);
- valuation methodology, and systems for ensuring that this policy is adhered to;
- authority and level of knowledge of risk managers and/or independent price-checkers;
- format and content of risk reports;
- limits, and systems for measuring and monitoring usage of those limits;
- type of documentation to be used, and other legal risks;
- clearing and settlement procedures;
- adequacy of the firm's computer systems for representing the new transaction type(s);
- reliance on key staff;
- risks arising from the remuneration strategy.

Senior management should approve the procedures and controls and management at all levels must understand and enforce them.

Risk appetite

It is crucial that a firm understands the risks to which credit derivatives give rise, and that resulting exposures are consistent with the overall risk appetite of the firm, as approved by the Board or equivalent management body. At the highest level, firms will need to

consider their objectives in using such instruments. Are they buying and selling credit protection in order to diversify or hedge their portfolio of credit risk? Are they offering credit protection to others, thereby incurring risks which may need to be hedged? Are they seeking to make a turn from buying and selling credit protection? Or, as is most likely, a mixture of all three? The level of control required will, as ever, be a function of the trading strategy.

Understanding the products

Although many of risks to which credit derivatives give rise are familiar, it is important to understand the significant differences between these instruments and more traditional products of a similar nature.

For example, many commentators have drawn parallels between credit derivatives and products such as guarantees or insurance. While some credit derivatives exhibit many of the characteristics of both of these instruments, it is important to recognise a credit derivative as a product in its own right with its own set of associated risks. An over-reliance on similarities between products can lead to the obscuring of genuine differences between their risk characteristics.

Many default options have an economic structure similar to that of guarantees: if issuer A defaults in the repayment on maturity of a bond held by Firm X, Firm X can immediately put the defaulted bond to Firm Y at par in exchange for full payment. It is tempting to see this as analogous to a first on demand guarantee, where on a default by the guaranteed party the guarantor pays the guaranteed party's debt as if it were its own.

However, there is a strong argument that the legal risk in the derivative transaction is greater than that in the guarantee, since guarantee documentation has been tested in the courts over centuries, whereas the default option documentation is as yet untried. It can therefore be argued that while the economic intent may be similar in the two products, there is greater risk engendered by following the credit derivative path rather than the well-trodden guarantee route.

Given that the market is still in a fairly early stage of development, and that structures and terminologies are not yet standardised, participants should be aware of the transactional risks involved and ensure that they have fully understood (and exchanged confirmation of) the exact commercial terms of the transactions entered into.

Credit approval

Firms will need to consider the mechanisms in place for approval of the acquisition of credit risk. Will the sale of credit protection be subject to appropriate levels of credit approval, and will the process be the same as that for other credit exposures the firm incurs? Is the approval process separate from the dealing function? Are those making the decisions fully aware of the particular risks of credit derivatives? It would plainly be dangerous for product originators, whose prime motivation will often be the provision of innovative financial engineering solutions for clients, to be committing the firm to acquiring risk, without the nature of that risk being fully understood, and consequently approved, by those responsible for the protection of the firm's assets. There may be a need for education of those making credit decisions in the peculiar risks inherent in credit derivatives, particularly if the decision to incur risk is truly to be kept separate (in management terms) from those who are trading it.

Mismatches and imperfect hedges

In documenting credit derivatives, firms should review the degree to which default criteria match in the reference asset and the derivative. In the simplest asset structures, mere failure to pay constitutes default; if this is matched in the derivative the credit hedge is clearly highly effective. If, alternatively, further conditionality is imposed in the default criteria of the derivative -for example, the payoff is triggered only when a payment has failed and this fact has become public and the price of the underlying has been affected by more than a certain amount -then the hedge is less effective.

Consideration should also be given to maturity mismatches. Where the underlying credit exposure continues beyond the maturity of the hedge, firms may wish to consider the appropriate exposure reporting treatment. For example, where the underlying credit risk is deteriorating, and default is considered probable, but not before the expiry of any protection held, is it prudent to consider the risk to be transferred at all? Arguably not only is the risk not transferred, but firms should be giving consideration to provisioning.

Where firms sell credit protection, the question of the firm's rights in a receivership or bankruptcy will be crucial. For example, if a firm receives an underlying bond when it is called under any protection sold, then it will clearly have rights in any eventual receivership. However, a structure where a firm merely undertakes to pay an amount to a protection buyer in the event of the default of the reference asset, and the protection seller acquires no rights in bankruptcy against the defaulting party, will have a wholly different risk profile.

The degree of correlation between the default of the reference asset and that of the protection seller must be considered. Where the two are highly correlated, it will plainly be inappropriate to regard the risk as effectively transferred. Would it be prudent to consider exposure to a sovereign issuer to be reduced by the purchase of protection from an entity located in the same country? Is protection sold by a subsidiary a valid hedge against a parent company exposure?(In the latter case firms may also wish to consider any legal restrictions which there may be on the support of parent companies by subsidiaries).

None of the foregoing is to say that firms should not enter in to imperfect credit hedges, merely that they should be aware of the risks involved in doing so, and ensure that these are reflected in the monitoring and review procedures applied.

Monitoring of credit exposures

A firm 's systems must be capable of aggregating credit exposures arising from credit derivatives with other exposures to a given entity. Furthermore, systems must be capable of reflecting the "dual " credit risk exhibited by many credit derivatives: where protection is bought for an asset held in the firm 's portfolio, the firm has credit exposure both to the issuer of the reference asset and to the protection seller. Similarly, where cash flows are swapped, a firm may acquire a dual risk, depending on the exact nature of the structure. Firms should ensure that they have monitoring systems which are capable of reflecting this dual risk, so that exposure to both the issuer of the reference asset and to the protection seller can be monitored.

Credit review and provisioning procedures

In considering the ongoing credit review of exposures, firms will again need to address the dual nature of the exposure to which most credit derivatives give rise. They will need to review both the financial strength of the underlying credit risk and the creditworthiness of the protection seller from whom protection has been bought. In this regard firms may wish to investigate fully the rights they have to financial information on the underlying credit risk and whether any restrictions in access to information would put a seller of protection at a disadvantage compared to a holder of the underlying credit risk, and whether any such disadvantage significantly alters the risk profile. Plainly where there is a lack of transparency, and firms may not be party to information which holders of the reference asset may receive, there will be a need for greater vigilance in monitoring.

Traditionally, securities houses have rarely become involved in "work outs ". However, where firms become the ultimate bearer of the credit risk of a certain counterparty, they will need to consider whether they have the necessary expertise in insolvency to make the best recovery possible. While it can be argued that even defaulted instruments can be sold "at a price ", such a sale may result in greater financial loss than if the firm managed the recovery itself.

Scenario testing

It is important that any firm which incurs significant trading risk undertakes a rigorous and comprehensive programme of scenario testing covering all major types of risk, including market risk, credit risk and operational risk. Routine scenario testing should be undertaken in order to aid the measurement and control of risks in 'normal' circumstances. In addition 'stress' scenarios should be designed to test the potential for losses under extreme conditions, or to highlight possible risk control problems that may arise. These should include -

- abnormal market movements;
- periods of inactivity or illiquidity;and

- the break-down of key assumptions.

Individual firms will need to devise tests which are meaningful to their particular situations; in each case the criteria should explicitly identify plausible events or influences to which the firm could be exposed. Of crucial importance in the case of credit derivatives is that the results should be capable of clear interpretation even where, by the very nature of the instruments, the distinction between market risk and credit risk becomes somewhat blurred. In addition, credit pricing is evolving as the derivatives market develops, and subjective judgements may need to be made in order to price or mark to market these instruments, which may in turn affect the performance of the hedge. Such judgements should be routinely reviewed and their potential effect included within the scenario testing.

The results of scenario testing should be regularly communicated to senior management, and to the Board or equivalent body, and should be reflected in the policies and limits set by management.

Reality testing

The essence of reality testing is the comparison of actual trading results with expected outcomes. Firms are familiar with the idea of checking whether their assumptions about the direction of markets have held, but have been slower to apply similar techniques to credit spreads, ratings migration and default.

Any firm which incurs credit risk in its trading activities should ensure that it has a mechanism to test whether, and to what extent, its assumptions have been robust. There should also be a recognised route for the results of reality testing to feed back into the process governing the way in which the firm limits its risk-taking activity.

REGULATORY CAPITAL TREATMENT

Some of the products which are by common consent termed credit derivatives are covered by the FSA's rules (for example, options on an individual bond or equity). Other instruments, however, show characteristics of a type not explicitly covered by the rules, and for these products the FSA has in the past provided guidance on an ad-hoc, though consistent basis. Both the credit derivatives market, and indeed the international regulatory capital regime, are evolving, and the FSA does not believe it is appropriate at this stage to propose rule changes to accommodate the full range of new products. The following paragraphs outline the general approach which the FSA will follow, and show the way in which capital charges might be calculated for some given examples of transactions. However, **any firm with a position in a credit derivative product should seek guidance on its treatment from the FSA.** There is as yet little standardisation of products, and an apparently small difference in specification might require a significant change in capital treatment.

Mark to market

Valuation is fundamental to the question of capital adequacy, as it has a direct effect on firms' financial resources. The FSA requires marking on a 'close-out' basis --a long position should be valued at the bid side of the market, and a short position at the offered side. Where a product is illiquid, the bid-offer spread available in the market will tend to be wide, and this must be reflected in the mark to market value. Firms are also required to take account of factors such as the size of the position. For example, if the size is larger than that for which a market bid-offer spread would hold, the spread must be widened to take account of this.

Credit derivatives offer certain additional challenges to the valuation process, but the FSA believes that the principles remain the same. There are many products commonly traded by authorised firms which, because of their peculiar characteristics, are complex to value, but which the FSA nonetheless requires to be marked to market. In all cases, the valuation must reflect the level at which a firm realistically expects to be able to liquidate the position. Where there is any uncertainty, the overriding principle is that of prudence.

Notwithstanding this, the reliability of the pricing process for some credit default products may leave regulators with a residual concern. For this reason, **a firm's proposed methodology for marking to market must be agreed with the FSA**. In extreme cases, the FSA may require extra buffers to be included in the valuation, and may even restrict any unrealised profit from inclusion in a firm's financial resources.

For the sake of clarity it should be noted that all credit derivatives must be marked to market, whether or not they are trading book positions, and that they must be marked on a close-out basis.

Trading book/non-trading book

The FSA believes that it is likely that most credit derivative transactions entered into by firms will be trading book items, and will therefore be subject to PRR and CRR. Some firms are aiming to develop a two-way market and others have bought protection for specific assets or asset classes in their trading book. Where a credit derivative position is clearly not a trading book item, it will be subject to a liquidity adjustment of either 100% or 8% (depending on which method a firm uses to calculate its financial resources).

Position Risk Requirement

Most credit derivative products can be slotted into the standard calculation methodologies (i.e. equity methods 1-4, and interest rate methods 1-3). The PRR calculation is divided into two distinct parts, being 'general market risk' and 'specific risk'. Some credit default products may not give rise to general market risk; where this is the case, instruments are likely to incur only the specific risk component of the relevant PRR charge.



Example 1:Credit default option

Firm A purchases option from Firm B.

A Credit Event is defined in terms of the default of XYZ Co.8% notes 1999.Should a Credit Event occur, Firm B will pay Firm A £1m against delivery of £1m nominal of XYZ Co.8% notes 1999.

For firm A -

General market risk:Nil

Specific risk: PRA of reference asset *nominal amount

Where the default protection is embedded in a credit-linked note issued by a third party, it is likely that both general market risk and specific risk charges will apply. Since there is a dual issuer risk, two specific risk charges should be calculated.

Example 2: Credit-linked note

Firm A holds a note issued by ABC Co, maturity 5 years, coupon 8%.

Should a Credit Event occur, the note is terminated. The Credit Event is defined in terms of the default of a bond issued by a third party - XYZ Co.

General market risk: 5 year PRA for relevant currency *mark to market value of note.

Specific risk: (PRA ABC Co + PRA XYZ Co) * mark to market value of note.

General market risk: 5 year PRA for relevant currency *mark to market value of note.

Specific risk: (PRA ABC Co + PRA XYZ Co) * mark to market value of note.

A total return swap should be treated as two notional positions, representing respectively the interest rate leg, and a position in the reference asset.

Example 3: Total return swap

Firm A pays 3 months LIBOR and any price depreciation on 100 XYZ Co shares;

Firm B pays dividend and any price appreciation on 100 XYZ Co shares.

Firm A: short debt equivalent position at three months; long equity equivalent position in 100 XYZ Co.

Firm B: long debt equivalent position at three months; short equity equivalent position in 100 XYZ Co.

Firms are reminded that if they are in any doubt as to the appropriate PRR treatment for any position or exposure, they should seek guidance from the FSA.

Offset for capital adequacy purposes

The Capital Adequacy Directive allows the competent authorities to recognise certain offsets for general market risk, but requires that the specific risk charge is applied to gross positions.

Where a position in a credit derivative has been represented as a notional debt or equity position, it automatically becomes eligible for the netting provisions set out in 10-83 and 10-102.

Example 4: Total return swap + hedge

Firm A pays 3 months LIBOR and any price depreciation on 100 XYZ Co shares;

Firm B pays any price appreciation and dividends on 100 XYZ Co shares.

Firm A is short 100 shares in XYZ Co.

Firm A's long equity equivalent position arising from the swap may be netted with its short position, giving rise to a zero PRR for the equity position.

PRR must still be calculated on the LIBOR leg.

Where a firm has a position in a credit default product that incurs only a specific risk charge, together with a position in the reference asset, the FSA may permit the two specific risk charges to be offset, provided that the credit events specified in the default product are to all intents and purposes the same as those specified for the reference asset.

Example 5:Credit default option +position in reference asset

Firm A holds option described in example 1.

Firm A is long £1m nominal XYZ Co. 8% notes 1999.

General market risk: 2 year PRA for relevant currency *mark to market value of bond.

Specific risk:nil

There may be other circumstances in which it is both legal and appropriate to recognise the hedging benefits of certain credit derivatives.**Firms are encouraged to discuss individual strategies with the FSA .**

Counterparty risk requirement

OTC credit derivatives,whether structured as swaps or options,give rise to counterparty risk. CRR for most credit derivative transactions will fall under rule 10-174: the appropriate part of Table 10-174(3)to be used in calculating the 'credit equivalent amount ' should be determined by the nature of the reference asset.

Example 6:Credit default option

Firm A purchases from Firm B the option described in Example 1.

Credit equivalent amount = replacement cost + £50,000 [i.e. 0.5% of £1m]

Some firms may use credit derivatives to reduce their exposure to a counterparty. EU law does not permit the recognition of such hedging in all cases,but the FSA is prepared to consider on a case-by-case basis whether the protection provider may be substituted for the counterparty for the purposes of the CRR rules.**Firms wishing to investigate this possibility should contact the FSA .**

Large exposures

Exposures incurred in both buying and writing credit derivatives should of course be taken into account for the purposes of calculating a firm's large exposures requirement. Where a firm holds an asset together with a hedge that is recognised as such by the FSA, it may choose to calculate its large exposures capital requirement in terms either of the exposure to the underlying or of the exposure to the entity providing the protection. This is not an entirely free choice, however: firms must be consistent in how they view credit protection. For example, if the protection has been taken into account when calculating PRR, an exposure to the provider must be reflected for large exposures purposes.

For the purposes of internal and regulatory monitoring of large exposures, the exposure to both the reference asset and to the protection provider should be indicated.

Multiple name risk

Where a firm is exposed to issuer risk of more than one issuer, for example where writing a credit default derivative which pays out on the default any one of a number of specified instruments: in general PRR should be calculated with reference to the aggregate of the specific risk weightings of the instruments in the reference basket (i.e. on an additive basis).

However, in cases where the derivative instrument/credit linked note has been afforded a credit rating by a 'relevant agency' which accords with the definition of 'qualifying debt security' firms may apply to the FSA to use the relevant single specific risk weighting from Appendix 53.

Risk assessment models

In the light of the forthcoming CADII package of directives, firms may also wish to consider whether to approach the FSA for permission to use an appropriate risk assessment model as the basis for calculating regulatory capital requirements.

SPECIFIC RISK TREATMENT OF CREDIT DERIVATIVES

Introduction

The following guidance is to clarify the specific risk treatments applicable to 'plain vanilla' credit derivatives such as credit default products, total return swaps and credit-linked notes.

Where a firm has a position in a more complex credit derivative instrument for which no PRR treatment has been specified, the firm must immediately seek guidance from the FSA. Until an appropriate treatment has been determined a PRR of 100% of the current mark to market value of the position must be applied.

Default Events

The following guidance applies only in circumstances where the default events, as drafted under the terms of the credit derivative, match those relating to the underlying reference asset. If default events are different, no hedging benefit should be recognised.

Specific Risk

Specific interest rate risk is the risk that the price of a specific security will change relative to prices of securities generally. Such a change is generally attributable to a change in the perceived creditworthiness of the issuer.

Credit derivatives are represented as a notional long or short position in the specific risk of the reference asset. If premium or interest payments are due under the swap, these cashflows are represented as a notional position in a Zone A government bond with the appropriate fixed or floating rate coupon.

Netting

A firm may net long and short positions in the same equity, debt and derivative instruments (under Chapter 10 rule 10-83 for equities based instruments and rule 10-102 for interest-rate based products) before the specific risk charge is applied to the resultant net long or short position. **Instruments are considered to be the same where the issuer is the same, they have equivalent ranking in liquidation, and the currency, coupon and maturity are the same.** These netting criteria are taken from Annex I (Position Risk) of the Capital Adequacy Directive ("CAD I")

Specific risk offset

Firms may net notional specific risk positions in reference assets resulting from credit derivative positions against actual positions in the reference asset or other notional positions created by other credit derivatives providing the conditions set out in rules 10-83 or 10-102 are met (see 'Netting' above).

Example 1

A firm holds a position of £10mn nominal of XYZ Ltd 6%2004 bond. The firm has bought protection (short credit risk) on this bond with a £10mn notional credit default swap referenced to this bond. The maturity of the credit default swap is 2004.

Under rule 10-102(1) the firm may net the notional position in specific risk created as a result of the swap against the actual position in the bond leaving a flat position. Therefore no specific risk charge is incurred. As credit default products do not attract a general market risk charge, general market risk is calculated on the cash position only.

Example 2

A firm has sold protection (long credit risk) via a credit default swap on £5mn notional of ABC Ltd 8%2000. It has backed out the risk by buying £5mn of protection on the same reference asset. Documentation relating to the two transactions is identical.

Again, under rule 10-102(2) the firm may net the long and short notional positions in the reference asset leaving a flat position. No specific risk charge is incurred.

Maturity Mismatch

Where a credit default product or credit linked note is of shorter maturity than the reference asset, a specific risk offset is allowed between the long and short specific risk positions. However, the unhedged period creates a forward position in specific risk of the reference asset. The net result is a single specific risk charge for the longer maturity position in the reference asset. This is the treatment agreed with the UK Supervisory Group on Credit Derivatives.

Note: This treatment does not apply to total return swaps, where no forward position in specific risk of the reference asset is recorded in cases of maturity mismatch because of the way the TRS resets, i.e. the TRS will compensate for movements in the market value which go beyond that of a credit event (a CLN/CDS will only provide protection at maturity where there has been a credit event).

Example

A firm is holding £3mn DEF Ltd 8.5%2003 bond. It hedges this position by entering into a credit default swap referenced to this asset but with maturity of 2002.

The notional position in specific risk resulting from the credit default swap may be netted against the actual position in the bond. However, after 2002 the position is unhedged. This results in a forward position in the specific risk of the reference asset. An appropriate specific risk charge should be applied to the longer maturity position in the reference asset from commencement of the transaction.

Asset Mismatch

Where a firm enters into a credit derivative hedge referenced to an asset other than the underlying asset they are seeking to hedge, there is basis risk between the reference asset and the underlying asset. Specific risk offsets are not available under the standard FSA rules in the case of an asset mismatch.

If a firm is hedging a long position in a credit default option with a short position, specific risk offsets are available only if the two notional positions in the reference assets meet the requirements of Rule 10-102(3).

Example

A firm hedges £3mn GHI Ltd 7%2005 bond by buying protection via a credit default swap. The maturity of the swap matches that of the underlying asset, however the swap is referenced to GHI Ltd 10%2005 bond.

The short notional position created as a result of the swap is not eligible for netting against the underlying position as it does not meet the netting criteria of rule 10-102. Unlike the situation with maturity mismatches where some netting benefit is recognised, two specific risk charges must be calculated – one on the underlying asset and one on the notional position.

Chapter 13: Financial Resource Requirements for Personal Investment Firms

APPLICATION

- 13.1 R (1) This chapter applies to a *firm* which is a *personal investment firm*.
- (2) Sections 13.1 to 13.8 apply to a *personal investment firm* which is a *Category A firm*.
- (3) Section 13.1 and sections 13.9 to 13.12 apply to a *personal investment firm* which is a *Category B firm*.
- (4) The definitions in the Glossary at Appendix 13(1) apply to this chapter.
- 13.1.1A G *Firms* are reminded that a *media firm* is not a *personal investment firm*.

GENERAL REQUIREMENTS

- 13.1.2 R **A *firm* must:**
- (1) **have and maintain at all times financial resources of the kinds and amounts specified in, and calculated in accordance with, the *rules* of this chapter; and**
- (2) **be able to meet its liabilities as they fall due.**

REQUIREMENT TO HOLD PROFESSIONAL INDEMNITY INSURANCE

- 13.1.3(1) G Under *Principles* 3 and 4 a *firm* is required to take reasonable care to organise and control its affairs responsibly and effectively with adequate risk management systems and to maintain adequate financial resources. Under *Principle* 9 a *firm* is obliged to take reasonable care to ensure the suitability of its *advice on investments* and discretionary decisions for any *customer* who is entitled to rely upon its judgement.
- 13.1.3(2) G Although financial resources and appropriate systems and controls can generally mitigate operational risk, professional indemnity insurance has a role in mitigating the risks a *firm* faces in its day to day operations, including those arising from not meeting the legally required standard of care when *advising on investments*. The purpose of 13.1.4(1) to 13.1.4(15) is to ensure that a *firm* has in place the type, and level, of professional indemnity insurance necessary to mitigate these risks. This includes, in the case of a *UK firm* exercising an *EEA right*, cover for breaches of obligations imposed by or under laws, or provisions having the force of law, in each *EEA State* in which the *firm* carries on business.

- 13.1.3(3) R The term "relevant income" in IPRU(INV) 13.1 refers to all income received or receivable which is commission, brokerage, fees or other related income, whether arising from the *firm's permitted activities* or not, for the last accounting year prior to inception or renewal of the professional indemnity insurance policy ("the policy").
- 13.1.4(1) R A *firm* must take out and maintain at all times professional indemnity insurance that is at least equal to the requirements of 13.1.4(2) to 13.1.4(15).

POLICY TERMS

- 13.1.4(2) R The policy must incorporate terms which are appropriate and must make provision for:
- (a) cover in respect of any claim for loss or damage, for which the *firm* may be liable as a result of an act or omission by:
 - (i) the *firm*; or
 - (ii) any *person* acting on behalf of the *firm* including *employees, appointed representatives* or its other agents;

LIMITS OF INDEMNITY – IMD INSURANCE INTERMEDIARY

- (b) appropriate minimum *limits of indemnity* per year, which are, if the *firm* is an *IMD insurance intermediary*, no lower than:
 - (i) €1,000,000 for a single claim against the *firm*; and
 - (ii) €1,500,000 in the aggregate;

LIMITS OF INDEMNITY – NON-IMD INSURANCE INTERMEDIARY

- (c) if the *firm* is not an *IMD insurance intermediary*, then the following *limits of indemnity* apply:
 - (i) if the *firm* has relevant income of up to £3,000,000, no lower than £500,000 for a single claim against the *firm* and £500,000 in the aggregate; or
 - (ii) if the *firm* has relevant income of more than £3,000,000, no lower than £650,000 for a single claim against the *firm* and £1,000,000 in the aggregate.
- 13.1.4(3) R If a policy is denominated in any currency other than euros, an *IMD insurance intermediary* must take reasonable steps to ensure that the *limits of indemnity* are, when the policy is effected (i.e. agreed) and at renewal, at least equivalent to those required in 13.1.4(2)(b).

READILY REALISABLE OWN FUNDS

- 13.1.4(4)** G For the purposes of the following provisions relating to professional indemnity insurance, the *FSA* expects items included in *own funds* to be regarded as "readily realisable" only if they can be realised, at any given time, within 90 days.

ADDITIONAL REQUIREMENTS

- 13.1.4(5)** E (a) In addition to the specific requirements in 13.1.4(2), to incorporate appropriate terms, the policy should make provision for the following:
- (i) for a *firm* with relevant income of more than £6,000,000, the aggregate limit identified in the table below:

Relevant income is (£)		Minimum aggregate <i>limit of indemnity</i> (£)
more than	up to	
6,000,000	7,000,000	1,150,000
7,000,000	8,000,000	1,300,000
8,000,000	9,000,000	1,450,000
9,000,000	10,000,000	1,600,000
10,000,000	12,500,000	2,000,000
12,500,000	15,000,000	2,400,000
15,000,000	17,500,000	2,800,000
17,500,000	20,000,000	3,150,000
20,000,000	25,000,000	3,800,000
25,000,000	30,000,000	4,250,000
30,000,000	35,000,000	4,500,000
35,000,000	40,000,000	4,750,000
40,000,000	50,000,000	5,500,000
50,000,000	60,000,000	6,000,000
60,000,000	70,000,000	6,750,000
70,000,000	80,000,000	7,250,000
80,000,000	90,000,000	7,750,000
90,000,000	100,000,000	8,500,000
100,000,000	150,000,000	11,250,000
150,000,000	200,000,000	14,000,000
200,000,000	250,000,000	17,000,000
250,000,000	300,000,000	19,750,000
300,000,000	n/a	22,500,000

- (ii) full retroactive cover in respect of the kinds of liabilities described in 13.1.4(2) for claims arising from work carried out by the *firm*, or on its behalf, in the past; and
 - (iii) cover in respect of *Ombudsman* awards made against the *firm*.
- (b) Compliance with (a) may be relied on as tending to establish compliance with the requirement in 13.1.4(2) for the *professional indemnity insurance* terms to be appropriate.
 - (c) Contravention of (a) may be relied on as tending to establish contravention of the requirement in 13.1.4(2) for the professional indemnity insurance terms to be appropriate.
- 13.1.4(6)** G A *firm* should consider whether the overall cover is adequate taking account of 13.1.4(9)(b) and whether the *firm* should seek additional cover or legal expenses insurance. (Legal defence costs are costs of defence against claims that fall under the terms of the policy.)
- 13.1.4(7)** G The cover provided by the policy should be wide enough to include the liability of the *firm*, its *appointed representatives*, *employees* and its agents for breaches of the *firm's* duty of skill and care, fiduciary duty, duty to look after documents or assets, fraud, and breaches of obligations imposed by or under *the Act* (or the Financial Services Act 1986 if relevant). If the *firm* operates outside the *UK* then the policy should cover other regulatory requirements imposed under the laws of other countries in which the *firm* operates.

EXCLUSIONS

- 13.1.4(8)** R **The policy must not be subject to conditions or exclusions which unreasonably limit the cover provided for in 13.1.4(2) (whether by exclusion of cover, by policy excesses or otherwise).**
- 13.1.4(9)** G (a) The *FSA* considers it reasonable for a *firm's* policy to exclude cover for:
- (i) specific business lines if that type of business has not been carried out by the *firm* in the past and will not be carried out by the *firm* during the life of the policy; or
 - (ii) specific claims that have been previously notified to the *firm's insurer* and claimed for under another policy.
- (b) The *FSA* does not consider it reasonable for a *firm's* policy to treat legal defence costs cover as part of the *limits of indemnity* if this reduces the cover available for any individual substantive claim.

13.1.4(10) E (a) The policy should not:
)

- (i) make provision for payment by the *firm* of an excess on any claim of more than £5,000. (This does not apply to the extent that the *firm* holds additional *own funds* in a readily realisable form, in accordance with 13.1.4(12)); or
 - (ii) exclude any type of business or activity that has been carried out by the *firm* in the past or will be carried out by the *firm* during the time for which the policy is in force. (This does not apply to the extent that the *firm* holds, by way of additional *own funds* in a readily realisable form, an amount equivalent to a reasonable provision against its potential liabilities for that business or activity. Guidance on this is given in 13.1.4(13) and (14)); or
 - (iii) exclude liability which is identified or crystallised as a result of regulatory action against the *firm* (either individually or as a member of a class of *authorised person*).
- (b) Contravention of (a) may be relied on as tending to establish contravention of 13.1.4(8).

EXCESS LEVEL

13.1.4(11) E The reference to "excess" in 13.1.4(10)(a)(i) is to the highest excess level required to be paid under the policy unless that excess relates to a type of business that has not been carried out by the *firm* in the past. In those circumstances, the reference is to the next highest excess level required by the policy.
)

ADDITIONAL OWN FUNDS

13.1.4(12) E The amount of additional *own funds* in 13.1.4(10)(a)(i) should be calculated by referring to the *firm's* relevant income and excess obtained in the following table:
)

All amounts are shown in £000s														
Relevant income is		Excess obtained, up to and including												
more than	up to	5	10	15	20	25	30	40	50	75	100	150	200+	
0	100	0	4	7	9	12	14	18	21	28	34	45	54	
100	200	0	7	11	14	17	20	25	29	38	46	59	70	
200	300	0	9	14	18	21	24	30	35	45	54	69	82	
300	400	0	11	16	21	24	28	34	39	50	60	77	91	
400	500	0	13	18	23	27	30	37	43	55	66	83	98	
500	600	0	14	20	25	29	33	40	46	59	70	89	105	
600	700	0	16	22	27	31	35	42	49	63	74	94	111	
700	800	0	17	23	28	33	37	45	52	66	78	99	117	
800	900	0	18	24	30	35	39	47	54	69	82	103	122	
900	1,000	0	19	26	31	36	41	49	56	72	85	107	126	
1,000	1,500	0	23	31	37	43	48	57	66	83	99	124	146	
1,500	2,000	0	26	35	42	48	54	64	73	93	109	138	161	
2,000	2,500	0	29	38	46	53	59	71	81	102	121	152	179	
2,500	3,000	0	32	42	51	58	65	78	89	112	132	166	195	
3,000	3,500	0	35	46	55	63	71	84	96	121	142	179	210	
3,500	4,000	0	38	50	59	68	76	90	102	129	152	191	223	
4,000	4,500	0	41	53	63	72	80	95	108	137	161	202	236	
4,500	5,000	0	43	56	67	76	85	100	114	144	169	212	248	
5,000	6,000	0	48	62	73	84	93	110	125	157	185	231	271	
6,000	7,000	0	52	67	79	90	101	119	135	169	199	249	291	
7,000	8,000	0	56	72	85	97	107	127	144	181	212	265	310	
8,000	9,000	0	59	76	90	103	114	134	152	191	224	280	328	
9,000	10,000	0	63	80	95	108	120	141	160	201	236	294	344	
10,000	100,000	0	63y	80y	95y	108y	120y	141y	160y	201y	236y	294y	344y	
100,000	n/a	0	630	800	950	1080	1200	1410	1600	2010	2360	2940	3440	

For *firms* with relevant income more than £10m but up to £100m value y is calculated by relevant income/ £10m

EXCLUSIONS

- 13.1.4(13) G A *firm* should take into account the following when assessing the amount of additional *own funds* to be held as provision as described in 13.1.4(10)(a)(ii):
- (a) the type of business line or activity excluded and the types of claim which might arise from it;
 - (b) the number of contracts written or volume of activity;
 - (c) the number of complaints received by the *firm* relating to the excluded business or activity;
 - (d) generally accepted accounting principles applicable to provisions; and
 - (e) any other relevant information.
- 13.1.4(14) G If the *firm* holds additional *own funds* in accordance with 13.1.4(13) then the amount should be reviewed regularly. The reviews should take account of changes in the status of the policy exclusion(s) and any relevant changes to the *firm's* circumstances.

POLICIES PROVIDING COVER FOR MORE THAN ONE FIRM

- 13.1.4(15) R **If the policy provides cover to more than one *firm* then in relation to 13.1.4(2) and (3):**
- (a) **the relevant income for calculating the *limits of indemnity* is that of all the *firms* named in the policy combined;**
 - (b) **each *firm* named in the policy must have the benefit of the minimum *limits of indemnity* as required in 13.1.4(2);**
 - (c) **each *firm* named in the policy must notify the FSA if the aggregate cover in the policy falls below the minimum in 13.1.4(2).**

EXEMPTION FROM HOLDING PROFESSIONAL INDEMNITY INSURANCE

- 13.1.5 R (1) **A *firm* is not required to effect or maintain professional indemnity insurance if a *bank, building society, insurer* or a *firm* which is a *friendly society* provides the *firm* with a comparable guarantee**
- (2) If the *firm* is a member of a *group* in which there is a *bank, building society, insurer* or a *firm* which is a *friendly society*, the *firm's* comparable guarantee must be from that *bank, building society, insurer* or *friendly society*.

- (3) A comparable guarantee means **an enforceable, written agreement** on terms at least equal to those required by *IPRU(INV) 13.1.4(2)R*.

- 13.1.6 **R A firm must take out professional indemnity insurance from:**
- (a) **any insurance undertaking** which is authorised to transact professional indemnity insurance in the *EEA*; or
 - (b) **a person of equivalent status in**
 - (i) **a Zone A country;**
 - (ii) **the Channel Islands, Gibraltar, Bermuda or the Isle of Man.**

NOTIFICATION REQUIREMENTS

- 13.1.7 **G Rule 13.1.9 is a notification rule** and is in addition to any notification requirements in the Supervision Manual (Sup 15).
- 13.1.8 **G Firms are reminded to comply with SUP 15.7 (Form and method of notification)** when notifying the *FSA* in accordance with *rule 13.1.9*.
- 13.1.9 **R A firm must notify the FSA immediately it becomes aware, or has information which reasonably suggests, that any of the matters in Table 13.1(1) has occurred, may have occurred or may occur in the foreseeable future.**

Table 13.1(1)

This table forms part of 13.1.9

NOTIFIABLE EVENTS	
1.	In relation to professional indemnity insurance, required in accordance with 13.1.4(1) to 13.1.4(15) and 13.1.5, if:
(a)	it cannot be obtained within 28 days of the inception or renewal date;
(b)	it is cancelled;
(c)	the amount of aggregate cover is exhausted;
(d)	the <i>firm</i> commences business lines for which it had not obtained cover;

(e)	the <i>firm</i> is relying on 13.1.4(15); or
(f)	the <i>firm</i> is relying on 13.1.5.
2. In respect of a <i>Category A firm</i> complying with section 13.3:	
(a)	<i>own funds</i> falling below the applicable reference level;
(b)	<i>own funds</i> reaching the applicable € level specified in <i>rule</i> 13.3.1;
(c)	change of control causing loss of eligibility for that alternative test;
3. <i>Category A firms</i> ;	
(a)	exposures to other <i>undertakings</i> in the <i>firm's group</i> exceeding in aggregate 20 per cent of <i>own funds</i> ;
(b)	a <i>large exposure</i> exceeding 25 per cent of <i>own funds</i> ;
(c)	aggregate <i>large exposures</i> exceeding 800 per cent of <i>own funds</i> ;
(d)	continuation of a <i>large exposure</i> in accordance with <i>rule</i> 13.6.2D;
(e)	default by a counterparty in a stock repurchase or reverse repurchase agreement or a <i>securities</i> lending or borrowing transaction;
(f)	exceeding the limits specified in <i>rule</i> 13.6.2 and complying instead with table 13.6.2(2);

RECORD KEEPING REQUIREMENTS

- 13.1.10 R **A *firm* must take reasonable steps to ensure that it:**
- (1) **keeps records which are sufficient to show at any time that it has complied with the requirements of this chapter; and**
 - (2) **establish procedures and controls to ensure that those records are made promptly and accurately and, where appropriate, brought up-to-date at regular and frequent intervals.**
- 13.1.11 G When establishing record keeping systems *firms* are expected to bear in mind the advantage of records which will enable them to demonstrate easily their compliance with the *rules* and the effectiveness of their own procedures and controls.
- 13.1.12 R **A *firm* must ensure that its records are kept up-to-date and:**

- (1) show with reasonable accuracy at any time the *firm's* financial position at that time;
- (2) enable the *firm* to demonstrate its continuing compliance with the applicable financial resource requirements; and:
- (3) provide the information needed to enable
 - (a) the *firm* to prepare the financial statements and reports required by or under the *rules*; and
 - (b) any auditor required to report on the *firm's* financial statement to form an opinion on them in accordance with the relevant requirements.

13.1.13 G Records should be capable of presenting a clear picture of the *firm's* financial viability.

- 13.1.14 R
- (1) A *firm* may hold its records in any form but it must
 - (a) keep them in English and up-to-date, and
 - (b) be able to produce them promptly at its business premises on paper at the *FSA's* request.
 - (2) If a *firm* retains records away from the place or places at which it conducts business, it must notify the *FSA* in accordance with the provisions of SUP 15 of the address and telephone number of the place or places at which they are kept.
 - (3) The *firm* must keep its records in such a way that
 - (a) any particular record is promptly accessible, and
 - (b) any particular transaction is clearly shown, easily traceable through the *firm's* accounting records and sufficiently explained.
 - (4) If the *firm* does not keep all records relating to financial resource requirements in one place, the *firm* must ensure that there is a clear indication that this is the case and provide accessible and adequate means of tracing all relevant records.

RELIANCE ON THIRD PARTIES

13.1.15 R A *firm* may rely on records provided by a third party provided that the *firm* reconciles those records with its own.

SECURITY

13.1.16 R A *firm* must take reasonable steps to protect its records at all times against loss, unauthorised access, alteration or destruction.

RETENTION OF RECORDS

- 13.1.17 R **A firm must retain any record required by the *rules* or the rules of a *previous regulator* for a period of six years after the time the record is made.**

13.2 Financial Resources Tests

- 13.2.1 R **A *Category A firm* must meet:**
- (1) **Financial Resources Test 1 (the *Own funds Test*) calculated in accordance with section 13.3;**
 - (2) **Financial Resources Test 1A (the *Adjusted Net current assets Test*) calculated in accordance with section 13.4; and**
 - (3) **Financial Resources Test 2 (the *Expenditure-based Test*) calculated in accordance with section 13.5.**
- 13.2.2 G Where a *Category A firm* deals as principal or as agent (as distinct from arranging transactions) in any of the following financial instruments, namely *units in collective investment schemes, securities or traded options* and other *derivatives*, the “trading book” provisions of section 13.8 are relevant to the *Category A firm*.
- 13.2.3 G Table 13A is a summary of the financial resources test for *Category A firm*.

Table 13.A

This table forms part of guidance 13.2.3

SUMMARY OF FINANCIAL RESOURCES FOR CATEGORY A FIRMS				
Type of firm	Financial Resources Test 1 <i>Own funds Test</i>	Financial Resources Test 1A <i>Adjusted net current assets Test</i>	Financial Resources Test 2 <i>Expenditure-based Test</i>	Rule/section references
Category A1 (including any Network in this category)	*€730,000	Adjusted <i>net current assets</i> of £1	Financial resources equal to the highest of 13/52 of Relevant Annual Expenditure or £400 per <i>adviser</i> or £10,000	13.3.1(1) 13.3.2 13.4 13.5.1 and 13.5.1A and 13.5.2 to 13.5.4A
Category A2 which is permitted to carry on the activity of managing investments or to delegate such activity to an investment firm	*€125,000	Adjusted <i>net current assets</i> of £1	Financial resources equal to the higher of 13/52 of Relevant Annual Expenditure or £400 per <i>adviser</i>	13.3.1(2) 13.3.2 13.4 13.5.1 and 1B and 13.5.2 to 13.5.4A
Category A2 with 26+ advisers	*€125,000	Adjusted <i>net current assets</i> of £1	Financial resources equal to the highest of 8/52 of Relevant Annual Expenditure or 13/52 of Relevant Annual Expenditure without <i>special adjustments</i> or £400 per <i>adviser</i>	13.3.1(2) 13.3.2 13.4 13.5.1C and 13.5.2 to 13.5.4A

Category A2 with 1-25 advisers	*€125,000	Adjusted <i>net current assets</i> of £1	Financial resources equal to the highest of 4/52 of Relevant Annual Expenditure or 13/52 of Relevant Annual Expenditure without <i>special adjustments</i> or £400 per <i>adviser</i>	13.3.1(2) 13.3.2 13.4 13.5.1C to D and 13.5.2 to 13.5.4A
Category A3 which is permitted to carry on the activity of managing investments or to delegate such activity to an investment firm	*€50,000	Adjusted <i>net current assets</i> of £1	Financial resources equal to the highest of 8/52 of Relevant Annual Expenditure or 13/52 of Relevant Annual Expenditure without <i>special adjustments</i> or £400 per <i>adviser</i>	13.3.1(3) 13.3.2 13.4 13.5.1C to D and 13.5.2 to 13.5.4A

Category A3 which is not permitted to carry on the activity of managing investments or to delegate such activity to an investment firm	*€50,000	Adjusted <i>net current assets</i> of £1	Financial resources equal to the highest of 4/52 of Relevant Annual Expenditure or 13/52 of Relevant Annual Expenditure without <i>special adjustments</i> or £400 per <i>adviser</i>	13.3.1(3) 13.3.2 13.4 13.5.1C to D and 13.5.2 to 13.5.4A
Network in Category A2	*€125,000	Adjusted net current assets of £1	Financial resources equal to the higher of 13/52 of Relevant Annual Expenditure or £400 per <i>adviser</i>	13.3.1(2) 13.3.2 13.4 13.5.1 to 1B and 13.5.2 to 13.5.4A
Network in Category A3	*€50,000	Adjusted net current assets of £1	Financial resources equal to the higher of 13/52 of Relevant Annual Expenditure or £400 per <i>adviser</i>	13.3.1(3) 13.3.2 13.4 13.5.1 to 1B and 13.5.2 to 13.5.4A
* Or the <i>firm's</i> highest reference level, in accordance with <i>rules</i> 13.3.3 to 3B				

13.3 **Financial Resources Test 1 - Own funds**

REQUIREMENT

13.3.1 **R Unless rules 13.3.3 to 3B apply, a Category A firm's own funds must at all times be at least:**

(1) for a Category A1 firm: €730,000; or

(2) for a Category A2 firm: €125,000; or

(3) for a Category A3 firm: €50,000.

13.3.1A **G** These resources may be denominated in sterling but, for the purposes of this test, must be translated into Euros (€) at the current official conversion rate (published daily in the national press).

CALCULATION OF OWN FUNDS

13.3.2 **R A Category A firm's own funds must be calculated in accordance with tables 13.3.2(1) and (2).**

Table 13.3.2(1)

This table forms part of rule 13.3.2

FINANCIAL RESOURCES TEST 1 - OWN FUNDS		
Companies		Sole Traders; Partnerships
(1) Paid up ordinary <i>share</i> capital	A	Balances on proprietor's or partners'
(1A) <i>Eligible LLP members' capital</i>		(5) capital accounts
(2) <i>Share</i> premium account		(6) current accounts (see 13.3.2AR) (to the extent that the profits are audited and the interim net profits are <i>verified</i>)
(3) Audited reserves (excluding revaluation reserves) (see 13.3.2AR) and <i>verified</i> interim net profits		
(4) Non-cumulative preference <i>shares</i> (if not redeemable by shareholders within 5 years)		
Initial Capital (applicants for authorisation)		

less (7) <i>Investments in own shares</i> (8) Intangible assets (9) <i>Material current year losses</i> (10) <i>Material holdings in credit and financial institutions</i> (10A) <i>Excess LLP members' drawings</i>	B	less (8) Intangible assets (9) <i>Material current year losses</i> (10) <i>Material holdings in credit and financial institutions</i> (11) Excess of current year drawings over current year profits
Original <i>own funds</i> (A minus B) C		
(12) Revaluation reserves (13) Cumulative preference <i>share capital</i> (if not redeemable by shareholders within 5 years) (14) Long-term subordinated loans (15) Preference <i>share capital</i> (if not redeemable by shareholders within 2 years) and <i>debt capital</i>	D	(12) Revaluation reserves (14) Long-term subordinated loans
<i>Own funds</i> (C plus D) (firms)		

13.3.2A R For the purpose of calculating a *Category A firm's own funds*, the following adjustments apply to audited reserves or, (for non-corporate entities), current accounts figures.

- (1) a *Category 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;
- (2) a *Category A firm* must derecognise any *defined benefit asset*;
- (3) a *Category A firm* may substitute for a *defined benefit liability* its *deficit reduction amount*. The election must be applied consistently in respect of any one financial year;
- (4) a *Category A firm* must deduct any unrealised gains on investment property and include these within revaluation reserves;
- (5) where applicable, a *Category 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.

- 13.3.2B G A *firm* should keep a record of and be ready to explain to its supervisory contacts in the *FSA* 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*.

Table 13.3.2(2)

This table forms part of *rule 13.3.2*

OWN FUNDS - RESTRICTIONS
(1) An applicant for authorisation must use only Initial Capital (items (1) to (4) or (5) and (6)) in calculating its resources to meet Financial Resources Test 1.
After obtaining authorisation a <i>firm</i> may use <i>Own funds</i> (items (1) to (15)) for that calculation.
(2) The admissible amount of items (12) to (15) must not be greater than 100% of Original <i>Own funds</i> .
(3) The admissible amount of items (13) and (14) must not be greater than 50% of Original <i>Own funds</i> .

Alternative to Financial Resources Test 1

13.3.3 R [deleted]

13.3.3A R [deleted]

13.3.3B R [deleted]

13.4 **Financial Resources Test 1A - Adjusted net current assets**

13.4.1 R **A *Category A firm* must adjust its *net current assets* as follows:**

- (1) **exclude assets which cannot be realised or recovered within twelve months;**
- (2) **exclude amounts receivable from *connected persons* to the extent that they are not *properly secured*, except amounts that are *deposits* referred to at item (11) in Part I of table 13.5.4(1) or at item (11) in Part I of table 13.5.4(2);**
- (3) **value *investments* at current *market value*, using the *bid price* for a *net long position* in an investment and the *offer price* for a *net short position* in an investment;**
- (4) **where applicable, deduct any asset in respect of deferred acquisition costs and add back in any liability in respect of deferred income (but exclude from the deduction or addition any asset or liability which will give rise to future cash flows), together with any associated deferred tax.**

13.4.2 R **A *Category A firm* must at all times have adjusted *net current assets* of at least £1.**

13.5 Financial Resources Test 2 – Expenditure-based Requirement

REQUIREMENT

- 13.5.1 R A *Category A firm* specified in *rules* 13.5.1A to 13.5.1B must have at all times financial resources which equal or exceed the amount specified in the applicable *rules*.
- 13.5.1A R A *Category A1 firm*, including a *Network*, must have financial resources calculated in accordance with whichever of (1), (2) or (3) produces the highest amount:
- (1) 13/52 of its relevant annual expenditure, calculated in accordance with *rules* 13.5.2; or
 - (2) an amount equal to £400 multiplied by the number of its *advisers*; or
 - (3) £10,000.
- 13.5.1B R A *Category A2 firm* which is permitted to carry on the activity of *managing investments* or to delegate such activity to an *investment firm*, or a *Network* in *Category A2* or *A3*, must have financial resources calculated in accordance with whichever of (1), or (2) produces the higher amount:
- (1) 13/52 of its relevant annual expenditure, calculated in accordance with *rule* 13.5.2; or
 - (2) an amount equal to £400 multiplied by the number of its *advisers*.
- 13.5.1C R (1) A *Category A2 firm* with more than 25 *advisers* which is not a *Network* and is not permitted to carry on the activity of *managing investments* or to delegate such activity to an *investment firm* must have financial resources calculated in accordance with whichever of (3), (4) or (5) produces the highest amount.
- (2) A *Category A3 firm* which is permitted to carry on the activity of *managing investments* or to delegate such activity to an *investment firm* must have financial resources calculated in accordance with whichever of (3), (4) or (5) produces the highest amount.
 - (3) Financial resources which taking into account all the *special adjustments* amount to 8/52 of its relevant annual expenditure, calculated in accordance with *rule* 13.5.2; or

- (4) financial resources which disregarding all the *special adjustments* amount to 13/52 of its relevant annual expenditure, calculated in accordance with *rule 13.5.2*; or
- (5) financial resources taking into account all the *special adjustments* of an amount equal to £400 multiplied by the number of its *advisers*.
- 13.5.1D R (1) **A Category A2 firm with fewer than 26 advisers which is not a Network and is not permitted to carry on the activity of managing investments or to delegate such activity to an investment firm must have financial resources calculated in accordance with whichever of (3), (4) or (5) produces the highest amount.**
- (2) **A Category A3 firm which is not permitted to carry on the activity of managing investments or to delegate such activity to an investment firm must have financial resources calculated in accordance with whichever of (3), (4) or (5) produces the highest amount.**
- (3) **Financial resources which taking into account all the *special adjustments* amount to 4/52 of its relevant annual expenditure calculated in accordance with *rules 13.5.2*; or**
- (4) **financial resources which disregarding all the *special adjustments* amount to 13/52 of its relevant annual expenditure, calculated in accordance with *rules 13.5.2*; or**
- (5) **financial resources taking into account all the *special adjustments* of an amount equal to £400 multiplied by the number of its *advisers*.**

CALCULATION OF RELEVANT ANNUAL EXPENDITURE

- 13.5.2 R (1) **A Category A firm must calculate its relevant annual expenditure by reference to the amount described as total expenditure in its most recently prepared set of *annual financial statements*. If those statements were for a period other than 12 months, the amounts in the *firm's* profit and loss account must be adjusted proportionately.**

- (2) Where a *Category A firm* has just begun trading or has not been authorised long enough to submit such statements, the *firm* must calculate its relevant annual expenditure on the basis of forecast or other appropriate accounts submitted to the *FSA*.
- (3) A *Category A firm* may, subject to *rule 13.5.3*, deduct from its total expenditure the items set out in table 13.5.2.

Table 13.5.2

This table forms part of *rule 13.5.2*

DEDUCTIONS FROM EXPENDITURE	
(a)	Staff bonuses (except to the extent that they are guaranteed);
(b)	<i>employees' and directors' shares</i> in profits (except to the extent that the amount is guaranteed);
(c)	other appropriations of profits;
(d)	shared commissions paid which are directly related to commissions received;
(e)	interest charges in respect of borrowing made to finance the acquisition of its <i>readily realisable investments</i> ;
(f)	interest paid to <i>clients</i> on <i>client money</i> ;
(g)	interest paid to <i>counterparties</i> ;
(h)	fees, brokerage and other charges paid to <i>recognised clearing houses, exchanges and intermediate brokers</i> for the purposes of executing, registering or clearing transactions;
(i)	foreign exchange losses;
(j)	a <i>firm</i> must not deduct any exceptional expenditure.

13.5.2A G (1) Salaries of *directors* or partners are not eligible for deduction, except to the extent that they can be demonstrated to be non-fixed costs of the *firm*.

(2) The deduction in item (c) is intended to cover forms of remuneration, other than those set out in (b), that are not fixed or guaranteed.

ADJUSTMENTS TO CALCULATION OF RELEVANT ANNUAL EXPENDITURE

- 13.5.3 R **A *firm* must ensure that the expenditure base properly reflects the ongoing annual operating costs of the *firm* by having proper regard to its circumstances when deciding whether to include or exclude any item of expenditure or to make any other adjustment to the calculation of relevant annual expenditure.**
- 13.5.3A G In *rule* 13.5.3 the FSA would expect a *firm* to take proper account of the effect of, for example, the ongoing annual operating costs of the *firm* being met by another party, or of a significant change in the structure of the *firm's* business during the year.

CALCULATION OF FINANCIAL RESOURCES TO MEET TESTS 1, 1A OR 2

- 13.5.4 R **A *Category A firm* must be able to calculate its financial resources at any time on the basis of the balance sheet it could draw up at that time. For this purpose:**
- (1) **a *Category A1 firm* must adjust the assets in the balance sheet as specified in table 13.5.4(1) and include the liabilities after making the adjustments specified in table 13.5.4(1).**
 - (2) **a *Category A2 or A3 firm*, must adjust the assets in the balance sheet as specified in table 13.5.4(2) and include the liabilities after making the adjustments specified in table 13.5.4(2).**
 - (3) **the assets and liabilities in the balance sheet are also subject to the following adjustments:**
 - (a) a *firm* must deduct any unrealised gains or, where applicable, back in any unrealised losses on cash flow hedges of financial instruments measured at cost or amortised cost;
 - (b) in respect of a *defined benefit occupational pension scheme*, a *firm* must derecognise any *defined business asset*;
 - (c) 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;
 - (d) 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 exclude from the deduction or addition any asset or liability which will give rise to future cash flows), together with any associated deferred tax.
- 13.5.4A R **A *Category A firm* must be able to identify separately any trading book items as indicated in *rule* 13.8 and any *special adjustments*.**

<p>(4) Debtors relating to Unsettled Securities Transactions – Cash against Documents</p>	<p>Include debtors where a <i>firm</i> has entered into a transaction in <i>securities</i> or <i>units in collective investment schemes</i> on a cash against documents basis and the transaction remains unsettled, after deducting an amount calculated by</p> <p>(a) computing the difference between the agreed settlement price for those <i>investments</i> and their current <i>market value</i> where that difference is not in the <i>firm's</i> favour, and</p> <p>(b) multiplying that difference by the applicable percentage specified in table 13.5.4B</p>	<p>A Counterparty Risk Adjustment</p>
<p>(5) Debtors relating to Unsettled Securities Transactions - Free Deliveries</p>	<p>If a <i>firm</i> has delivered <i>securities</i> or <i>units in collective investment schemes</i> before receiving payment for them, or paid for such <i>investments</i> before receiving certificates of good title for them, and not more than 3 days have passed since delivery, include debtors after deducting an amount calculated by</p> <p>(a) (i) (if a <i>firm</i> has delivered them) computing the full amount due to a <i>firm</i> under the contract;</p> <p>(ii) (if a <i>firm</i> has paid for them) computing their current <i>market value</i>; and</p> <p>(b) multiplying the amount or value at (a) by the applicable percentage specified in table 13.5.4C</p>	<p>A Counterparty Risk Adjustment</p>

	Exclude debtors if more than 3 days have passed since delivery.	An Illiquid Adjustment
(6) <i>Regulated collective investment schemes</i>	<p>Include an amount owing in respect of a transaction in <i>units</i> in a <i>regulated collective investment scheme</i> only</p> <p>(a) if the amount has been due and unpaid for 30 days or less after the settlement date of the transaction to which it relates, and</p> <p>(b) after discounting that amount by the applicable percentage specified in table 13.5.4C.</p> <p>Exclude amounts that have been due and unpaid for more than 30 days.</p>	<p>A Counterparty Risk Adjustment</p> <p>An Illiquid Adjustment</p>
(7) Debts of <i>group or connected companies</i>	Exclude in full unless otherwise allowed by the items in this table.	An Illiquid Adjustment
(8) Debtors	<p>Include amounts owing only in respect of</p> <p>(a) (i) commission;</p> <p>(ii) <i>investment management</i> fees;</p> <p>(iii) other fees earned in connection with the <i>firm's investment business</i>;</p> <p>which are due from other authorised or <i>EEA firms, recognised investment exchanges or recognised clearing houses</i> and have been due and unpaid for 30 days or less;</p> <p>(b) (i) <i>investment management</i> fees; or</p> <p>(ii) pensions administration</p> <p>which have been due from the <i>firm's</i> customers and unpaid for 30 days or less;</p> <p>after discounting the amounts in (a) and (b) by the applicable percentage specified in table 13.5.4C.</p>	A Counterparty Risk Adjustment

	Exclude amounts that have been due and unpaid for more than 30 days. All other debtors must be deducted in full.	An Illiquid Adjustment
(9) Prepayments	Include the amount of prepayments which relate to goods or services to be received or performed within 90 days, after discounting the amount by the applicable percentage specified in table 13.5.4C. Exclude the amount of prepayments relating to more than 90 days.	A Counterparty Risk Adjustment An Illiquid Adjustment
(10) Accrued income	Include accrued income not yet due and receivable in respect of fees earned in the performance of <i>investment management</i> services that is receivable within 90 days, after discounting the amount by the applicable percentage specified in table 13.5.4C. Exclude accrued income receivable after 90 days.	A Counterparty Risk Adjustment An Illiquid Adjustment
(11) <i>Deposits</i>	Include amounts in respect of (a) cash and balances on current accounts and on <i>deposit</i> accounts with an <i>approved bank</i> or National Savings Bank which can be withdrawn within 90 days; (b) money on <i>deposit</i> with a UK local authority which can be withdrawn within 90 days; (c) money <i>deposited</i> and evidenced by a certificate of tax <i>deposit</i> . Exclude amounts which can only be withdrawn after 90 days.	 An Illiquid Adjustment

(12) Other amounts due from Government bodies or local authorities	<p>Include other amounts due from UK Government bodies or local authorities if they are agreed and due within 30 days, after discounting the amounts by the applicable percentage specified in table 13.5.4C.</p> <p>Exclude amounts that are not due to be paid within 30 days.</p>	<p>A Counterparty Risk Adjustment</p> <p>An Illiquid Adjustment</p>
(13) All other assets	<p>Exclude in full.</p> <p>If not otherwise excluded in full in this table, this category should include any holding in eligible capital instruments of an insurance undertaking, insurance holding company, or reinsurance undertaking that is a <i>subsidiary</i> or participation.</p> <p>Eligible capital instruments include ordinary share capital, cumulative preference shares, perpetual securities and long-term subordinated loans, that are eligible for insurance undertakings under PRU 2.</p>	<p>An Illiquid Adjustment</p>
Where applicable - <i>Large exposures</i>	Deduct an amount calculated in accordance with 13.6.2	A <i>Large exposure</i> Adjustment

TABLE 13.5.4(1) PART II

This table forms part of *rule 13.5.4*

FIRMS IN CATEGORY A1		
LIABILITY	CALCULATION	TYPE OF ADJUSTMENT
(14) Secured Liabilities	<p>Include in full, except the amount of the liabilities secured by a charge on land and buildings which may be reduced by the smallest of the following amounts:</p> <p>(a) the aggregate amount of the <i>firm's</i> secured liabilities which are due more than one year after the balance sheet date;</p> <p>(b) (if the land and buildings have been valued by an independent professional valuer within the past 18 months) 85% of the amount certified by the valuer as their <i>market value</i>;</p> <p>(c) 85% of the net book value of land and buildings.</p>	An Illiquid Adjustment
(15) Sub-ordinated loans	<p>Include in full, except any long term or short term subordinated loan in the standard form prescribed by the <i>FSA</i> which may be treated as capital up to the limits specified in <i>SUP 16</i>.</p>	
(16) Commission on indemnity terms from the sale of <i>life policies</i> or <i>pension contracts</i>	<p>Include as a liability a provision for repayment, in the event that premiums cease within the indemnity period, which must equal or exceed 2.5% of the commissions the <i>firm</i> has received on indemnity terms during the previous twelve months. This provision must be reasonable having regard to the <i>firm's</i> circumstances and, in particular, its previous lapse ratio.</p>	An Illiquid Adjustment
(17) Investments (Short Positions)	<p>Include a <i>net short position</i></p> <p>(a) valued at its <i>offer price</i>, and</p> <p>(b) increased by the applicable percentage specified in table 13.5.4A</p>	A Position Risk Adjustment

(18) Deficiency in <i>subsidiary</i>	Include as a liability the amount by which the liabilities of any <i>subsidiary</i> (excluding its capital and reserves) exceed its tangible assets. This requirement applies only to the extent that the <i>firm</i> has not already made such a provision elsewhere in its financial statements.	An Illiquid Adjustment
(19) Liability for tax	Include as a liability a provision for taxation on the whole of the profits of the <i>firm's</i> business up to its balance sheet date.	An Illiquid Adjustment
(20) Creditors relating to Unsettled Securities Transactions - Cash against Documents	<p>Include creditors where a <i>firm</i> has entered into a transaction in <i>securities</i> or <i>units in collective investment schemes</i> as agent on a cash against documents basis, and the transaction remains unsettled, after adding an amount calculated by</p> <p>(a) computing the difference between the agreed settlement price for those <i>investments</i> and their current <i>market value</i>, and</p> <p>(b) multiplying that exposure by the applicable percentage specified in table 13.5.4B.</p>	A Counterparty Risk Adjustment
(21) Creditors relating to Unsettled Securities Transactions - Free Deliveries	<p>Include an amount for creditors where (acting as agent) a <i>firm</i> has delivered certificates of title for <i>securities</i> or <i>units in collective investment schemes</i> before receiving payment for them, or where (acting as principal) a <i>firm</i> has bought such <i>investments</i> before receiving certificates of good title for them, after adding an amount calculated by</p> <p>(a) (i) (if a <i>firm</i> has paid for them but not received certificates of good title for them) computing their current <i>market value</i>;</p> <p>(ii) (if a <i>firm</i> has delivered the certificates without receiving payment for them) computing the full amount due to the <i>firm</i> under the contract for sale; and</p> <p>(b) multiplying that value or amount by the applicable percentage specified in table 13.5.4C.</p>	A Counterparty Risk Adjustment

(22) <i>Over the counter derivatives</i>	Include as a liability an amount for its positions in such <i>derivatives</i> calculated by (a) computing the credit equivalent of those positions in accordance with table 13.5.4D, and (b) increasing that credit equivalent by the applicable percentage specified in table 13.5.4C, (in addition to making an adjustment in accordance with item (17) of this table and (in respect of bought <i>OTC</i> equity <i>options</i> and covered <i>warrants</i>) in accordance with item (25)).	A Counterparty Risk Adjustment
(23) Contingent Liabilities	A <i>firm</i> must include a provision for any contingent liabilities which exist at the <i>firm's</i> balance sheet date that must be made.	An Illiquid Adjustment
(24) Preference Shares	Include as a liability any amounts in excess of the amounts which may be treated as financial resources specified in table 13.3.2(2) and <i>SUP</i> 16.	
(25) <i>Net open foreign currency position</i>	Include as a liability an amount in respect of the <i>firm's</i> foreign exchange risk calculated in accordance with table 13.5.4E.	A Foreign Exchange Risk Adjustment
(26) All other liabilities	Include in full.	

<p>(4) Debtors relating to Unsettled Securities Transactions - Cash against Documents</p>	<p>Include debtors where the <i>firm</i> has entered into a transaction in <i>securities</i> or <i>units in collective investment schemes</i> as agent on a cash against documents basis and the transaction remains unsettled, after deducting an amount calculated by</p> <p>(a) computing the difference between the agreed settlement price for those <i>investments</i> and their current <i>market value</i> where that difference is not in the <i>firm's</i> favour, and</p> <p>(b) multiplying that difference by the applicable percentage specified in table 13.5.4B.</p>	<p>A Counterparty Risk Adjustment</p>
<p>(5) Debtors relating to Unsettled Securities Transactions - Free Deliveries</p>	<p>Where the <i>firm</i> has delivered <i>securities</i> or <i>units in collective investment schemes</i> before receiving payment for them, or paid for such <i>investments</i> before receiving certificates of good title for them, and not more than 3 days have passed since delivery, include debtors after deducting an amount calculated by</p> <p>(a) (i) (where the <i>firm</i> has delivered them) computing the full amount due to a <i>firm</i> under the contract;</p> <p>(ii) (where the <i>firm</i> has paid for them) computing their current <i>market value</i>; and</p> <p>(b) multiplying the amount or value at (a) by the applicable percentage specified in table 13.5.4C.</p> <p>Exclude debtors if more than 3 days have passed since delivery.</p>	<p>A Counterparty Risk Adjustment</p> <p>An Illiquid Adjustment</p>

(9) Prepayments	<p>Include the amount of prepayments which relate to goods or services to be received or performed within 90 days, after discounting the amount by the applicable percentage specified in table 13.5.4C.</p> <p>Exclude the amount of prepayments relating to more than 90 days.</p>	<p>A Counterparty Risk Adjustment</p> <p>An Illiquid Adjustment</p>
(10) Accrued income	<p>Include accrued income, including any such income not yet due and receivable in respect of fees earned in the performance of <i>investment management</i> services that is receivable within 90 days, after discounting the amount by the applicable percentage specified in table 13.5.4C.</p> <p>Exclude accrued income receivable after 90 days.</p>	<p>A Counterparty Risk Adjustment</p> <p>An Illiquid Adjustment</p>
(11) <i>Deposits</i>	<p>Include amounts in respect of</p> <ul style="list-style-type: none"> (a) cash and balances on current accounts and on <i>deposit</i> accounts with an <i>approved bank</i> or National Savings Bank which can be withdrawn within 90 days; (b) money on <i>deposit</i> with a UK local authority which can be withdrawn within 90 days; (c) money <i>deposited</i> and evidenced by a certificate of tax <i>deposit</i>. <p>Exclude amounts which can only be withdrawn after 90 days.</p>	<p>An Illiquid Adjustment</p>
(12) Other amounts due from Government bodies or local authorities	<p>Include other amounts due from UK Government bodies or local authorities if they are agreed and due within 90 days, after discounting the amounts by the applicable percentage specified in table 13.5.4C.</p>	<p>A Counterparty Risk Adjustment</p>

	Exclude amounts that are not due to be paid within 90 days.	An Illiquid Adjustment
(13) All other assets	Exclude in full. If not otherwise excluded in full in this table, this category should include any holding in eligible capital instruments of an insurance undertaking, insurance holding company, or reinsurance undertaking that is a <i>subsidiary</i> or participation. Eligible capital instruments include ordinary share capital, cumulative preference shares, perpetual securities and long-term subordinated loans, that are eligible for insurance undertakings under PRU 2.	An Illiquid Adjustment
Where applicable - <i>Large exposures</i>	Deduct an amount calculated in accordance with <i>rule</i> 13.6.2.	<i>A Large exposure</i> Adjustment

TABLE 13.5.4(2) PART II

This table forms part of *rule* 13.5.4

FIRMS IN CATEGORY A2 AND A3		
LIABILITY	CALCULATION	TYPE OF ADJUSTMENT
(14) Secured Liabilities	Include in full, except the amount of the liabilities secured by a charge on land and buildings which may be reduced by the smallest of the following amounts: (a) the aggregate amount of the <i>firm's</i> secured liabilities which are due more than one year after the balance sheet date; (b) (if the land and buildings have been valued by an independent professional valuer within the past 18 months) 85% of the amount certified by the valuer as their <i>market value</i> ; and (c) 85% of the net book value of land and buildings.	An Illiquid Adjustment
(15) Subordinated loans	Include in full except any long term or short term subordinated loan in the standard form prescribed by the <i>FSA</i> which may be treated as capital up to the limits specified in <i>SUP</i> 16.	

(16) Commission on indemnity terms from the sale of <i>life policies</i> or <i>pension contracts</i>	Include as a liability a provision for repayment, in the event that premiums cease within the indemnity period, which must equal or exceed 2.5% of the commissions the <i>firm</i> has received on indemnity terms during the previous twelve months. This provision must be reasonable having regard to the <i>firm's</i> circumstances and, in particular, its previous lapse ratio.	An Illiquid Adjustment
(17) <i>Investments</i> (Short Positions)	Include a <i>net short position</i> (a) valued at its <i>offer price</i> , and (b) increased by the applicable percentage specified in table 13.5.4A.	A Position Risk Adjustment
(18) Deficiency in <i>subsidiary</i>	Include as a liability the amount by which the liabilities of any <i>subsidiary</i> (excluding its capital and reserves) exceed its tangible assets. This requirement applies only to the extent that the <i>firm</i> has not already made such a provision elsewhere in its financial statements.	An Illiquid Adjustment
(19) Liability for tax	Include as a liability a provision for taxation on the whole of the profits of its business up to its balance sheet date.	An Illiquid Adjustment
(20) Creditors relating to Unsettled <i>Securities</i> Transactions Cash against Documents	Include creditors where a <i>firm</i> has entered into a transaction in <i>securities</i> or <i>units in collective investment schemes</i> as agent on a cash against documents basis, and the transaction remains unsettled, after adding an amount calculated by (a) computing the difference between the agreed settlement price for those <i>investments</i> and their current <i>market value</i> , and (b) multiplying that exposure by the applicable percentage specified in table 13.5.4B.	A Counterparty Risk Adjustment

(21) Creditors relating to Unsettled Securities Transactions Free Deliveries	Include an amount for creditors where (acting as agent) the <i>firm</i> has delivered certificates of title for <i>securities</i> or <i>units in collective investment schemes</i> before receiving payment for them, or where the <i>firm</i> has bought such <i>investments</i> before receiving certificates of good title for them, after adding an amount calculated by	A Counterparty Risk Adjustment
	(a) (i) (where the <i>firm</i> has paid for them but not received certificates of good title for them) computing their current <i>market value</i> ; (ii) (where the <i>firm</i> has delivered the certificates without receiving payment for them) computing the full amount due to a <i>firm</i> under the contract for sale; and (b) multiplying that exposure by the applicable percentage specified in table 13.5.4C.	
(22) <i>Over the counter derivatives</i>	Include as a liability an amount for its positions in such <i>derivatives</i> calculated by (a) computing the credit equivalent of those positions in accordance with table 13.5.4D, and (b) increasing that credit equivalent by the applicable percentage specified in table 13.5.4C, (in addition to making an adjustment in accordance with item (17) of this table and (in respect of bought <i>OTC</i> equity <i>options</i> and covered <i>warrants</i>) in accordance with item (25)).	A Counterparty Risk Adjustment
(23) Contingent Liabilities	A <i>firm</i> must include a provision for any contingent liabilities which exist at its balance sheet date that must be made.	An Illiquid Adjustment
(24) Preference Shares	Include as a liability any amounts in excess of the amounts which may be treated as financial resources specified in table 13.3.2(2) and <i>SUP</i> 16.	

(25) <i>Net open foreign currency position</i>	Include as a liability an amount in respect of its foreign exchange risk calculated in accordance with table 13.5.4E.	A Foreign Exchange Risk Adjustment
(26) All other liabilities	Include in full.	

TABLE 13.5.4A

This table forms part of *rule 13.5.4*

POSITION RISK			
The percentages in the table are applied to the <i>market value</i> (unless otherwise stated) of gross positions, i.e. both longs and shorts in each category; netting and offsetting are prohibited. The long or short position in a particular investment is the net of any long or short positions held in that same investment.			
INVESTMENT	DISCOUNT		
A. Debt		Maturity	
Central Government	0-2 years 2%	2-5 years 5%	>5 years 13%
<i>Qualifying debt security:</i>			
- fixed rate	8%	8%	15%
- floating rate	10%	10%	15%
<i>Non-qualifying debt security:</i>			
- fixed rate	10%	20%	30%
- floating rate	30%	30%	30%
B. Equities			
- <i>exchange traded</i>	25%		
- other	100%		

C. Derivatives	
- <i>exchange traded futures</i>	4 x initial margin requirement
- <i>OTC futures</i>	Apply the appropriate percentage shown in A and B to the <i>market value</i> of the underlying position
- <i>Purchased options</i>	Apply the appropriate percentage shown in A and B to the <i>market value</i> of the underlying position but the result may be limited to the <i>market value</i> of the option
- <i>Contracts for differences</i>	20% of the <i>market value</i> of the contract
D. Other Investments	
- <i>Units in regulated collective investment schemes</i>	25%
- <i>units in higher volatility funds or property funds</i>	50%
- <i>with profit life policies</i>	20% of surrender value
- <i>other</i>	100%

TABLE 13.5.4B

This table forms part of *rule 13.5.4*

UNSETTLED SECURITIES TRANSACTIONS	
Number of <i>business days</i> after due settlement date	Percentage
0 – 4	0
5 – 15	8
16 – 30	50
31 – 45	75
46 or more	100

TABLE 13.5.4C**This table forms part of rule 13.5.4**

COUNTERPARTY RISK	
Type of Counterparty	Deducti on
A counterparty which is, or the contract of which is, explicitly guaranteed by: <ul style="list-style-type: none"> - the government or central bank of the <i>United Kingdom</i> or another <i>Zone A country</i>; or - the <i>European Economic Area</i>; or - any other government or central bank, provided the exposure is denominated in that country's national currency. 	NIL
A counterparty which is, or the contract of which is, explicitly guaranteed by: <ul style="list-style-type: none"> - a local authority or regional government in the <i>United Kingdom</i> or another <i>Zone A country</i>; or - a <i>credit institution</i> authorised in the <i>United Kingdom</i> or another <i>Zone A country</i>; or - a recognised <i>clearing house</i> or recognised investment exchange; or - an <i>investment firm</i> or a comparable undertaking regulated by a <i>recognised third country</i>. 	1.6%
Any other counterparty	8%

TABLE 13.5.4D**This table forms part of rule 13.5.4**

OVER THE COUNTER DERIVATIVES		
a. By attaching current <i>market values</i> to contracts (marking to market), obtain the current replacement cost of all contracts with positive values.		
b. To obtain a figure for potential future credit exposure (except in the case of single currency “floating/floating interest rate swaps” in which only the current replacement costs will be calculated), multiply the notional principal amounts or values underlying the <i>firm's</i> aggregate positions by the following percentages:		
Residual Maturity	Interest Rate Contracts	Foreign Exchange Contracts
One year or less	Nil	1%
More than 1 year	0.5%	5%
c. The credit equivalent is the sum of current replacement cost and potential future credit exposure.		

TABLE 13.5.4E**This table forms part of rule 13.5.4**

FOREIGN EXCHANGE RISK
(a) A <i>firm</i> must deduct a foreign exchange risk requirement for all the following items which are denominated in a foreign currency: <ul style="list-style-type: none"> (i) all assets and liabilities, including accrued interest, denominated in the currency (all <i>investments</i> at market or realisable value); (ii) any currency future, at the nominal value of the contract; (iii) any forward contract for the purchase or sale of the currency, at the contract value, including any future exchange of principal associated with currency swaps; (iv) any foreign currency <i>options</i> at the net delta (or delta-based) equivalent of the total book of such <i>options</i>;

- (v) any non-currency option, at *market value*;
- (vi) any irrevocable guarantee;
- (vii) any other off-balance sheet commitment to purchase or sell an asset denominated in that currency.

(b) The requirement must be calculated as follows:

- (i) using the spot rate, convert the *net long position* and *net short position* in each foreign currency into the currency in which its *annual financial statements* are reported;
- (ii) total the *net open long positions* and the *net open short positions*;
- (iii) the higher of (i) and (ii) above is the *firm's net open foreign currency position*;
- (iv) multiply the *firm's net open foreign currency position* by 10%.

(c) A *firm* may not include any future income or expense not yet accrued but fully hedged (subject to deduction of an appropriate risk requirement).

SUBORDINATED LOANS

13.5.5 R **A *Category A firm* may treat a subordinated loan as a financial resource, as specified in table 13.3.2(1), and subject to *rule 13.5.5C*, if the long term or short term subordinated loan is eligible for such treatment in accordance with *rule 13.5.5A* or B as applicable.**

13.5.5A R **A long term subordinated loan is eligible for such treatment if:**

- (1) it is fully paid up;
- (2) it has an original maturity of at least five years, or where it has no fixed term, it is subject to five years' notice of repayment;
- (3) repayment, prepayment or termination is only permitted under the loan agreement:
 - (a) on maturity, or on expiration of the period of notice, if after such payment or termination a *firm* meets 120% of its financial resource requirement; or
 - (b) on winding up after the claims of all other creditors and all outstanding debts have been settled;

- (4) the amount used in the calculation of its financial resources is reduced on a straight line basis over the last five years of its term;
- (5) it is in the standard form prescribed by the *FSA* for long term subordinated loans.

13.5.5B R A short term subordinated loan is eligible for such treatment if:

- (1) it is fully paid up;
- (2) it has an original maturity of at least two years, or where it has no fixed term, it is subject to two years' notice of repayment;
- (3) payment of interest is not permitted under the loan agreement unless after such payment a *firm* meets 120% of its financial resources requirement;
- (4) repayment, prepayment or termination is only permitted under the loan agreement:
 - (a) on maturity, or on expiration of the period of notice, if after such payment or termination a *firm* meets 120% of its financial requirement; or
 - (b) on winding up after the claims of all other creditors and outstanding debts have been settled;
- (5) it is in the standard form prescribed by the *FSA* for short term subordinated loans.

13.5.5C R The total amount of long term or short term subordinated loans that a *Category A firm* may include in the calculation of its financial resources is restricted as stipulated in table 13.3.2(2) and in *SUP 16*.

13.6 Large exposures

13.6.1 R **A large exposure exists where a *Category A firm* is owed a debt by, or are otherwise exposed to, another person, or to two or more *affiliated persons*, and that exposure equals or exceeds 10% of its own funds.**

REQUIREMENTS

- 13.6.2 R **Subject to rules 13.6.2A to D a *Category A firm* must ensure that at all times**
- (1) **no large exposure exceeds 25% of its own funds;**
 - (2) **Where a *firm* is exposed to one or more of its *holding company*, its *subsidiary*, or a *subsidiary* or *group* of *subsidiaries* of its *holding company*, the aggregate of those exposures does not exceed 20% of the *firm's own funds*;**
 - (3) **the aggregate of the *firm's large exposures* does not exceed 800% of its own funds.**
- 13.6.2A R **A *Category A firm* may exclude from its calculations under rule 13.6.2 an exempt exposure in table 13.6.2(1).**
- 13.6.2B R **A *Category A firm* may not exclude any exposure covered by any excess of its financial resources over its expenditure based requirement as specified in rules 13.5.1 to 1D.**
- 13.6.2C R **A *Category A firm* may exceed the limits specified in rule 13.6.2 if**
- (1) **the limits in rule 13.6.2 are exceeded only by exposures relating to its trading book as indicated in rule 13.8.2;**
 - (2) **it provides additional financial resources in accordance with table 13.6.2(2) including the Special Limits set out at the foot of table 13.6.2(2); and**
 - (3) **it notifies the *FSA* immediately in accordance with SUP 15.7 (Form and method of notification).**
- 13.6.2D R **Where a *Category A firm* was legally bound to a large exposure on or before 5 February 1993, the *firm* may continue it until its contractual maturity provided that the *firm* has notified the *FSA* in accordance with SUP 15.7 (Form and method of notification) of such continuation.**

Table 13.6.2(1)**This table forms part of rule 13.6.2**

EXEMPT EXPOSURES	Exempt Percentage
(1) Any illiquid asset which is deducted in full in the calculation of its financial resources.	100
(2) Exposures connected with foreign exchange transactions, incurred in the ordinary course of settlement during the 48 hours following payment.	100
(3) Exposures in connection with transactions for the purchase or sale of <i>securities</i> incurred in the ordinary course of settlement during the five <i>business days</i> following payment or delivery of the <i>securities</i> , whichever is the earlier.	100
(4) Exposures to <i>Zone A</i> central governments or central <i>banks</i> .	100
(5) Exposures to the <i>European Economic Area</i> .	100
(6) Exposures guaranteed by <i>Zone A</i> central governments, central <i>banks</i> or the <i>European Economic Area</i> .	100
(7) Exposures secured by <i>securities</i> issued by <i>Zone A</i> central governments, central <i>banks</i> or the <i>European Economic Area</i> .	100
(8) Exposures secured by cash <i>deposits</i> placed with the lending institution.	100

(9) Exposures secured by certificates of <i>deposit</i> issued by the <i>firm</i> .	100
(10) Exposures to <i>Zone B</i> central governments or central <i>banks</i> denominated in the national currency of the borrower.	100
(11) Connected exposures, e.g. <i>group</i> treasury arrangements, provided that the <i>group</i> is supervised on a consolidated basis in accordance with the <i>FSA</i> 's requirements for consolidated supervision.	100
(12) Bills of trade with a maturity of less than one year accepted by a <i>credit institution</i> .	100
(13) Exposures secured by marketable <i>securities</i> provided that the <i>bid price</i> of the collateral exceeds the exposure as follows: <ul style="list-style-type: none"> - <i>shares</i>: 150% excess; - <i>qualifying debt securities</i>: 50% excess; - in all other cases: 100% excess 	100
(14) Cash balances held with <i>approved banks</i> (provided they can be withdrawn within 90 days).	100
(15) Exposures in financial instruments to <i>credit institutions</i> , <i>investment firms</i> , comparable <i>undertakings</i> regulated by recognised third countries, <i>recognised clearing houses</i> and <i>recognised investment exchanges</i> as follows: <ul style="list-style-type: none"> - exposures with a maturity of one year or less; - exposures with a maturity of more than one but not more than three years; (in the case of marketable debt instruments) exposures with a maturity of more than three years.	100 80 50
(16) Exposures to, or guaranteed by, State regional or local authorities.	80
(17) All low or medium risk off-balance sheet items (e.g. note issuance facilities).	50

CALCULATION OF FINANCIAL RESOURCES TO MEET TESTS 1, 1A OR 2

Table 13.6.2(2)

This table forms part of *rule 13.6.2*

CALCULATION OF ADDITIONAL FINANCIAL RESOURCES	
Note:	The restrictions to using this calculation set out in <i>rule 13.6.2C</i>
1.	Calculate <ol style="list-style-type: none">the <i>firm's</i> total non-trading book exposures (N);the <i>firm's</i> total trading book exposures (T);the sum of N and T (NT).
2.	Calculate the amount by which NT exceeds 25% of the value of the <i>firm's</i> financial resources (the excess - X).
3.	Rank the trading book exposures in NT in descending order: <ol style="list-style-type: none">in the case of positions, in accordance with the position risk discounts specified in table 13.5.4(1) or (2);in the case of counterparty exposures, in accordance with the counterparty risk deductions specified in table 13.5.4C.
4.	Sum r the trading book exposures in NT, starting with the exposure attracting the highest position isk discount or counterparty risk deduction, until the sum equals X.
5.	<ol style="list-style-type: none">If an excess (X) has lasted for no more than 10 days (disregarding the age of the exposures constituting that excess),<p>the additional requirement is 200% of the aggregate of the position risk adjustments and counterparty risk adjustments, as shown in <i>SUP 16</i> applicable to the exposures constituting the excess (X);</p>if an excess (X) has lasted for more than 10 days (disregarding the age of the exposures constituting that excess),<ol style="list-style-type: none">allocate the exposures making up that excess, in ascending order of position risk discount or counterparty risk deduction, to the appropriate row in the Schedule below, so that the highest discount or deduction is matched with the highest percentage; andcalculate the additional requirement by multiplying the position risk adjustment or counterparty risk adjustment, as shown in <i>SUP 16</i>, by the percentage specified in column 2 of the Schedule.

Excess (X) as a Percentage of Financial Resources 1			Percentage 2
up to		40	200
40	-	60	300
60	-	80	400
80	-	100	500
100	-	250	600
over		250	900

Special Limits

- (where an excess has lasted for 10 days or less) the excess must not exceed 500% of the *firm's own funds*;
- (where any excess has lasted for the *firm's own funds*).

13.7 [Deleted]

13.7.2B R **A *Category A firm* must, where it is exposed to undue risk in consequence of its membership of a *group*, provide against, reduce or eliminate that risk.**

13.8 Trading Book

13.8.1 G The “trading book” is a term generally used in the context of *credit institutions*, such as *banks*, but now extended to other *investment firms*. It separates their longer term lending, *deposit-taking* and investment activities (in the case of *banks* their “banking book”) from their shorter term trading activities in financial instruments such as *shares*, *units in collective investment schemes* and *traded options* (their “trading book”).

13.8.2 R **Where a *Category A firm* has a trading book, it must include only trading book items for the purposes of its financial resource calculations.**

13.8.3 G The following table 13.8(1) shows what items are classifiable as “trading book” items and what items cannot be so classified.

Table 13.8(1)

This table forms part of rule 13.8.2

Trading Book Items	Non-trading Book Items
(1) Proprietary positions in financial instruments which are held for resale and/or taken on with the intention of benefiting in the short-term from market fluctuations	(1) Foreign exchange exposures arising from net spot and forward forex positions (unless they are <i>investments</i> as defined in the Glossary)
(2) Positions in financial instruments arising from matched principal broking	(2) Receivables which are not directly related to items included in the trading book, such as fees, commission, interest or dividends
(3) Positions taken on specifically to hedge other elements of the trading book	(3) Illiquid assets

(4) Exposures relating to unsettled <i>securities</i> transactions which are either free deliveries or cash against documents transactions	(4) Other balance sheet or off balance sheet items (including long term <i>investments</i> held by <i>firms</i>).
(5) Exposures relating to <i>Over the counter derivative</i> instruments	
(6) Exposures relating to repurchase or reverse repurchase agreements or stock borrowing or lending transactions which are based on <i>securities</i> included in the trading book	
(7) Receivables which are directly related to items included in the trading book such as fees, commission, interest, dividends or margin on exchange traded <i>derivatives</i>	

13.9 Financial Resources Tests for Category B firms

13.9.1 R A *Category B firm* must meet:

- (1) financial Resources Test 1 (the *Own funds Test*) calculated in accordance with section 13.10;
- (2) Financial Resources Test 1A (the *Adjusted Net current assets Test*) calculated in accordance with section 13.11, unless the *firm* is a *low resource firm* which is not permitted to carry on the activity of *managing investments in* respect of portfolios containing only *life policies*; and
- (3) Financial Resources Test 2 (the *Expenditure-based Test*) calculated in accordance with section 13.12 unless the *firm* is a *low resource firm*.

13.9.1A G Table 13B is a summary of the financial resources test for a *Category B firm*.

Table 13B This table forms part of rule 13.9.1

SUMMARY OF FINANCIAL RESOURCES FOR CATEGORY B FIRMS				
Type of firm	Financial Resources Test 1 Own funds Test	Financial Resources Test 1A Adjusted <i>Net current assets</i> Test	Financial Resources Test 2 Expenditure-based Test	Rule/section References
Category B1 (including any <i>Network</i> in this category)	£10,000	Adjusted <i>net current assets</i> of £1	Liquid capital equal to the highest of 13/52 of relevant annual expenditure or £400 per adviser or £10,000	13.10 13.11 13.12.1C 13.12.2 to 13.12.5A0
Category B2 which is permitted to carry on the activity of <i>investment management</i> in respect of portfolios containing only <i>life policies</i> or to delegate such activity to an <i>investment firm</i>	£10,000	Adjusted <i>net current assets</i> of £1	Adjusted capital equal to the higher of 13/52 of relevant annual expenditure or £400 per adviser	13.10 13.11 13.12.1D 13.12.2 to 13.12.5A
Category B2 with 26+ advisers	£10,000	Adjusted <i>net current assets</i> of £1	Adjusted capital equal to the higher of 8/52 of relevant annual expenditure or £400 per adviser	13.10 13.11 13.12.1E 13.12.2 to 13.12.5A
Category B2 with 1-25 advisers	£10,000	Adjusted <i>net current assets</i> of £1	Adjusted capital equal to the higher of 4/52 of relevant annual expenditure or £400 per adviser	13.10 13.11 13.12.1F 13.12.2 to 13.12.5A

Category B3 which is permitted to carry on the activity of <i>managing investments in</i> respect of portfolios containing only <i>life policies</i> or to delegate such activity to an <i>investment firm</i>	£10,000	Adjusted <i>net current assets</i> of £1	Adjusted capital equal to the higher of 8/52 of relevant annual expenditure or £400 per adviser	13.10 13.11 13.12.1E 13.12.2 to 13.12.5A
Category B3 with 26+ advisers	£10,000	Adjusted <i>net current assets</i> of £1	Adjusted capital equal to the higher of 4/52 of relevant annual expenditure or £400 per adviser	13.10 13.11 13.12.1F 13.12.2 to 13.12.5A
Category B3 with 1 - 25 advisers	£10,000	N/A	N/A	13.10
<i>Network</i> in Category B2 or B3	£10,000	Adjusted <i>net current assets</i> of £1	Adjusted capital equal to the higher of 13/52 of relevant annual expenditure or £400 per adviser	13.10 13.11 13.12.1D 13.12.2 to 13.12.5A
All <i>Category B firms</i> that do not hold <i>client money</i> or assets, but are permitted to establish, operate or wind up a personal pension scheme.	£10,000	Adjusted <i>net current assets</i> of £1	Adjusted capital equal to the highest of 6/52 of relevant annual expenditure, £400 per adviser, £10,000 and any other expenditure-based requirement set out in 13.12.1 applicable to the <i>firm</i> .	13.10 13.11 13.12.1 13.12.2 to 13.12.5A
All <i>Category B firms</i> that do not hold <i>client money</i> or assets and are permitted to establish, operate or wind up a personal pension scheme.	£10,000	Adjusted <i>net current assets</i> of £1	Adjusted capital equal to the highest of 13/52 of relevant annual expenditure, £400 per adviser, and £10,000	13.10 13.11 13.12.1G 13.12.2 to 13.12.5A

13.10 **Financial Resources Test 1- Own funds Requirement**

REQUIREMENT

13.10.1 R ***A Category B firm's own funds must at all times be at least £10,000.***

CALCULATION

13.10.2 R ***A Category B firm's own funds must be calculated in accordance with table 13.10(2).***

Table 13.10(2).

This table forms part of *rule 13.10.2*

<i>OWN FUNDS</i>	
Companies	Sole Traders: Partnerships
Paid-up <i>share</i> capital (excluding preference <i>shares</i> redeemable by shareholders within 2 years) <i>Eligible LLP members' capital</i> Share premium account Retained profits (see 13.10.2AR) and interim net profits (Note 1) Revaluation reserves Short-term subordinated loans <i>Debt capital</i>	Balances on proprietor's or partners' capital accounts current accounts (see 13.10.2AR) Revaluation reserves Short-term subordinated loans
less Intangible assets Material current year losses <i>Excess LLP members' drawings</i>	less Intangible assets Material current year losses Excess of current year drawings over current year profits
<p>Note 1 Retained profits must be audited and interim net profits must be verified by the <i>firm's</i> external auditor, unless the <i>firm</i> is exempt from the provisions of Part VII of the Companies Act 1985 relating to the audit of accounts (section 249A (Exemptions from audit)).</p>	

13.10.2A

- R For the purpose of calculating a *Category B firm's own funds*, the following adjustments apply to retained profits or, (for non-corporate entities), current accounts figures.
- (1) a *Category B 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;
 - (2) a *Category B firm* must derecognise any *defined benefit asset*;
 - (3) a *Category B firm* may substitute for a *defined benefit liability* its *deficit reduction amount*. The election must be applied consistently in respect of any one financial year.
 - (4) a *Category B firm* must deduct any unrealized gains on investment property and include these within revaluation reserves.
 - (5) where applicable, a *Category B firm* must deduct any asset in respect of deferred acquisition costs and add back in any liability in respect of deferred income (but exclude from the deduction or addition any asset or liability which will give rise to future cash flows), together with any associated deferred tax.

- 13.10.2B G A *firm* should keep a record of and be ready to explain to its supervisory contacts in the *FSA* 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*.

Where a Category B firm is a sole trader or a partnership:

- (1) it can use (to the extent necessary to make up any shortfall in the required resources) any of its personal assets (not being needed to meet liabilities arising from its personal activities and any business activities not regulated by the *FSA*);
- (2) the *firm's* total financial resources, from whatever source, must at all times be sufficient to cover its total liabilities.

- 13.10.3 R (1) Where a *Category B3 firm* with 1-25 advisers has a facility under the *PASS Loan Agreement Scheme* it may make an adjustment in its *own funds* calculation in accordance with (2).
- (2) a *firm* in (1) can regard as additional to its *own funds* the lower of either:
- (a) the amount of the loan facility agreed (less any loan repayments already made and less the amount of the facility withdrawn or lapsed); or
 - (b) the amount of the *firm's* provision for redress (net of any professional indemnity insurance recoverable) at the time of its application for the loan facility.

13.11 Financial Resources Test 1A - Adjusted net current assets

APPLICATION

- 13.11.1 R This section does not apply to a *low resource firm*.

REQUIREMENT

- 13.11.2 R A *Category B firm* must adjust its *net current assets* as follows:
- (1) exclude assets which cannot be realised or recovered within twelve months;
 - (2) exclude amounts receivable from *connected persons* to the extent that they are not *properly secured*, except amounts that are *deposits* referred to in item (11) of table 13.12.3(1) or item (11) in table 13.12.3(2);

- (3) value *investments* at current *market value*, using the *bid price* for a *net long position* in an investment and the *offer price* for a *net short position* in an investment;
- (4) where applicable, deduct any asset in respect of deferred acquisition costs and add back in any liability in respect of deferred income (but exclude from the deduction or addition any asset or liability which will give rise to future cash flows), together with any associated deferred tax.

13.11.3 R A *Category B firm* must at all times have adjusted *net current assets* of at least £1.

13.12 Financial Resources Test 2 - Expenditure-based Requirement

APPLICATION

13.12.1A R This section does not apply to a *low resource firm*.

REQUIREMENT

13.12.1B R A *Category B firm* must have at all times financial resources calculated in accordance with *rules 13.12.2 to 13.12.5* which equal or exceed the amount specified in *rules 13.12.1C to F* as applicable.

13.12.1C R A *Category B1 firm*, including a *Network* must have financial resources calculated in accordance with whichever of (1), (2) or (3) produces the higher amount.

- (1) 13/52 of its relevant annual expenditure, calculated in accordance with 13.12.2 to 13.12.2D; or
- (2) an amount equal to £400 multiplied by the number of its *advisers*; or
- (3) £10,000;

13.12.1D R (1) A *Category B2 firm* which is permitted to carry on the activity of *investment management* in respect of portfolios containing only *life policies* or to delegate such activity to an *investment firm* must have financial resources calculated in accordance with whichever of (3) or (4) produces the higher amount.

(2) A *Network* in *Category B2* or *B3* must have financial resources calculated in accordance with whichever of (3) or (4) produces the higher amount.

- (3) **13/52** of its relevant annual expenditure, calculated in accordance with 13.12.2 to 13.12.2D; or
- (4) an amount equal to £400 multiplied by the number of its *advisers*.
- 13.12.1E R (1) **A *Category B2 firm* with more than 25 *advisers* which is not a *Network* and is not permitted to carry on the activity of *managing investments in* respect of portfolios containing only *life policies* or to delegate such activity to an *investment firm* must have financial resources calculated in accordance with whichever of (3) or (4) produces the higher amount.**
- (2) **A *Category B3 firm* which is permitted to carry on the activity of *investment management* in respect of portfolios containing only *life policies* or to delegate such activity to an *investment firm* must have financial resources calculated in accordance with whichever of (3) or (4) produces the higher amount.**
- (3) **8/52** of its relevant annual expenditure, calculated in accordance with 13.12.2 to 13.12.2D; or
- (4) an amount equal to £400 multiplied by the number of its *advisers*.
- 13.12.1F R (1) **A *Category B2 firm* with fewer than 26 *advisers* which is not a *Network* and is not permitted to carry on the activity of *managing investments in* respect of portfolios containing only *life policies* or to delegate such activity of *investment management* to an *investment firm* must have financial resources calculated in accordance with whichever of (3) or (4) produces the higher amount.**
- (2) **A *Category B3 firm* which is not permitted to carry on the activity of *investment management* in respect of portfolios containing only *life policies* or to delegate such activity to an *investment firm* must have financial resources calculated in accordance with whichever of (3) or (4) produces the higher amount.**
- (3) **4/52** of its relevant annual expenditure, calculated in accordance with 13.12.2 to 13.12.2D; or
- (4) an amount equal to £400 multiplied by the number of its *advisers*.
- 13.12.1G R **A *category B firm* whose permission includes *establishing, operating or winding up a personal pension scheme* must have financial resources calculated in accordance with (1) or (2):**
- (1) **For a *firm* which holds *client money* or assets, the highest of:**

- (a) **13/52 of its relevant annual expenditure, calculated in accordance with 13.12.2 to 13.12.2D;**
 - (b) **an amount equal to £400 multiplied by the number of its advisers; and**
 - (c) **£10,000.**
- (2) **For a *firm* which does not hold client money or assets, the highest of:**
- (a) **6/52 of its relevant annual expenditure, calculated in accordance with 13.12.2 to 13.12.2D;**
 - (b) **an amount equal to £400 multiplied by the number of its advisers;**
 - (c) **£10,000; and**
 - (d) **any other expenditure-based requirement set out in 13.12.1 applicable to the *firm*.**

CALCULATION OF RELEVANT ANNUAL EXPENDITURE

- 13.12.2 R **A *Category B firm* must calculate its relevant annual expenditure by reference to the amount described as total expenditure in its most recently prepared set of *annual financial statements*. If those statements were for a period other than 12 months, the amounts in its profit and loss account must be adjusted proportionately.**
- 13.12.2A R **Where a *Category B firm* has just begun trading or have not been authorised long enough to submit such statements the *firm* must calculate its relevant annual expenditure on the basis of forecast or other appropriate accounts submitted to the *FSA*.**
- 13.12.2B R **A *Category B firm* may deduct from its relevant annual expenditure items (a) to (f) set out in table 13.12.2, unless the *firm* is a *Category B1 firm*, in which case it may not deduct item (e).**

Table 13.12.2

This table forms part of *rule* 13.12.2

DEDUCTIONS FROM EXPENDITURE	
(a)	staff bonuses;
(b)	<i>employees' and directors' shares</i> in profits;
(c)	interest charges in respect of borrowing made to finance the acquisition of its <i>readily realisable investments</i> ;
(d)	shared commissions paid which are directly related to commissions received;
(e)	emoluments of <i>directors</i> , partners or a sole trader;
(f)	a <i>firm</i> must not deduct any exceptional expenditure.

ADJUSTMENTS TO CALCULATION OF RELEVANT ANNUAL EXPENDITURE

- 13.12.2 R **A firm must ensure that the expenditure base properly reflects the ongoing annual operating costs of the firm by having proper regard to its circumstances when deciding whether to include or exclude any item of expenditure or to make any other adjustment to the calculation of relevant annual expenditure.**
- C
- 13.12.2 G In rule 13.12.2C the FSA would expect a firm to take proper account of the effect of, for example, the ongoing annual operating costs of the firm being met by another party, or of a significant change in the structure of the firm's business during the year.
- D

CALCULATION OF FINANCIAL RESOURCES TO MEET TESTS 1, 1A OR 2

- 13.12.3 R (1) **This rule does not apply to a low resource firm;**
- (2) **A Category B firm must be able to calculate its financial resources at any time on the basis of the balance sheet the firm could draw up at that time. For this purpose:**
- (a) **a Category B1 firm must adjust the assets in the balance sheet as specified in Part I of table 13.12.3(1) and include the liabilities after making the adjustments specified in Part II of table 13.12.3(1);**
- (b) **a Category B2 or B3 firm to which 13.12 applies must adjust the assets in the balance sheet as specified in Part I of table 13.12.3(2) and include the liabilities after making the adjustments specified in Part II of table 13.12.3(2).**
- (3) the assets and liabilities in the balance sheet are also subject to the following adjustments:
- (a) a Category B 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;
- (b) in respect of a defined benefit occupational pension scheme, a Category B firm must derecognise any defined benefit asset;
- (c) a Category B 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;

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

Table 13.12.3(1) Part I

This table forms part of *rule 13.12.3*

<i>FIRMS CATEGORY B1</i>	
CALCULATION OF ASSETS	
ASSETS	ADJUSTMENTS
(1) Land and Buildings	Exclude in full. (A loan secured by a charge on land and buildings may be deducted from liabilities in accordance with item (14) of Part II of this table.)
(2) <i>Investments</i>	<p>Include any <i>net long position</i> in any fixed or current asset investment (including <i>shares</i> in any connected company)</p> <p>(a) valued at its current <i>bid price</i> (or, in the case of a with-profits <i>life policy</i>, at its surrender value), and</p> <p>(b) discounted by the applicable percentage specified in table 13.12.3A.</p> <p><i>A firm</i> which acts as a market-maker in second-hand <i>life policies</i> must comply with the relevant requirements in respect of second-hand <i>life policies</i> held by the <i>firm</i> and include such a <i>policy</i>.</p> <p>(a) valued at its surrender value at the date on which the <i>firm</i> acquired it, or its latest available surrender value if different.</p> <p>(b) where a life office whose <i>policy</i> is held by the <i>firm</i> has altered adversely the basis on which it calculates surrender values, the <i>firm</i> must revise its valuation of the second-hand <i>policy</i> as soon as practicable after becoming aware of the alteration.</p>
(3) <i>Investments</i> subject to Repurchase, Reverse Repurchase, Stock Borrowing or Stock Lending transactions	Include <i>investments</i> for which the <i>firm</i> has entered as principal into a repurchase, reverse repurchase, stock borrowing or stock lending transaction on its own behalf, after making (I) a deduction in accordance with item (2), and (II) a deduction calculated by computing its exposure (the difference between the <i>market value</i> of the <i>securities</i> and the loan or collateral (including accrued interest) where that difference is not in the <i>firm's</i> favour, after adjusting for any excess collateral).

(4) Debtors relating to Unsettled Securities Transactions Cash against Documents	<p>Include debtors where the <i>firm</i> has entered into a transaction on its own behalf in <i>securities</i> or <i>units in collective investment schemes</i> on a cash against documents basis, and the transaction remains unsettled, after deducting an amount calculated by</p> <p>(a) computing the difference between the agreed settlement price for those <i>investments</i> and their current <i>bid price</i> where that difference is not in the <i>firm's</i> favour, and</p> <p>(b) multiplying that difference by the applicable percentage specified in table 13.12.3B.</p>
(5) Debtors relating to Unsettled Securities Transactions Free Deliveries	<p>(a) Include the full amount due to the <i>firm</i> from debtors if a <i>firm</i> has delivered <i>securities</i> or <i>units in collective investment schemes</i> before receiving payment for them, or paid for such <i>investments</i> before receiving certificates of good title for them, so long as not more than three days have passed since delivery</p> <p>(b) If more than three days have passed since delivery, exclude in full.</p>
(6) <i>Regulated collective investment schemes</i>	<p>Include an amount owing in respect of a transaction in <i>units</i> in a <i>regulated collective investment scheme</i> only if the amount has been due and unpaid for 30 days or less after the settlement date of the transaction to which it relates.</p>
(7) Loans secured on <i>investments</i>	<p>If the <i>firm</i> holds client title documents as security for</p> <p>(a) the repayment of money it has lent; or</p> <p>(b) money due to the <i>firm</i> in connection with the purchase for or sale to another person of those <i>investments</i>, which the <i>firm</i> has for genuine commercial reasons agreed to postpone,</p> <p>the <i>firm</i> may include as an asset the lower of the following:</p> <p>(i) the total amount due;</p> <p>(ii) the <i>market value</i> of the <i>investments</i> multiplied by the appropriate rates set out in table 13.12.3A.</p>

(8) Trade debtors	<p>Include amounts owing only in respect of</p> <p>(a) (i) commission; (ii) <i>investment management fees</i>; (iii) other fees earned in connection with the <i>firm's investment business</i>, which are due from other authorised or <i>EEA firms, recognised investment exchanges</i> or <i>recognised clearing houses</i> and have been due and unpaid for 30 days or less;</p> <p>(b) (i) <i>investment management fees</i>; or (ii) pensions administration which have been due from its customers and unpaid for 30 days or less.</p> <p>(c) All other trade debtors must be deducted in full.</p>
(9) Prepayments	<p>Include prepayments which relate to goods or services to be received or performed within 90 days.</p>
(10) Accrued income	<p>(a) Accrued income relating to <i>investment management fees</i> not yet due and payable may be included if the fees relate to services provided within the previous six months.</p> <p>(b) Other accrued income may be included if it relates to interest on marketable debt instruments or on <i>deposits</i> included in item (11).</p>
(11) <i>Deposits</i>	<p>The following may be included:</p> <p>(a) cash and balances on current accounts and on <i>deposit</i> accounts with an <i>approved bank</i> or National Savings Bank which can be withdrawn within 90 days;</p> <p>(b) money on <i>deposit</i> with a UK local authority which can be withdrawn within 90 days;</p> <p>(c) money <i>deposited</i> and evidenced by a certificate of tax <i>deposit</i>.</p>

(12) Other Debts	<p>(a) Amounts owing in respect of</p> <ul style="list-style-type: none"> (i) interest on <i>investments</i>; (ii) repayments of marketable debt instruments at maturity or call; (iii) dividends declared by authorised or not <i>EEA firms</i> or by companies in respect of <i>shares</i> listed on a recognised or designated investment exchange; <p>which have been due and unpaid for 30 days or less may be included.</p> <p>(b) Other amounts due from UK government bodies may be included if they are agreed and due within 30 days.</p>
(13) All other assets	Exclude in full.

Table 13.12.3(1) Part II

This table forms part of *rule 13.12.3*

FIRMS IN CATEGORY B1	
CALCULATION OF LIABILITIES	
LIABILITIES	ADJUSTMENTS
(14) Secured Liabilities	<p>Include in full, except the amount of the liabilities secured by a charge on land and buildings which may be reduced by the smallest of the following amounts:</p> <ul style="list-style-type: none"> (a) the aggregate amount of the <i>firm's</i> secured liabilities which are due more than one year after the balance sheet date; (b) (if the land and buildings have been valued by an independent professional valuer within the past 18 months) 85% of the amount certified by the valuer as their <i>market value</i>; (c) 85% of the net book value of the land and buildings.
(15) Subordinated loans	Include in full, except any short-term subordinated loan in the standard form prescribed by the <i>FSA</i> which may be treated as capital up to the limits specified in <i>rules 13.12.5</i> and <i>13.12.5A</i> .

(16) Commission on indemnity terms from the sale of <i>life policies</i> or <i>pension contracts</i>	Include as a liability a provision for repayment, in the event that premiums cease within the indemnity period, which must equal or exceed 2.5% of the commissions the <i>firm</i> has received on indemnity terms during the previous twelve months. This provision must be reasonable having regard to its circumstances and, in particular, its previous lapse ratio.
(17) Short Positions	Include a <i>net short position</i> (a) valued at its <i>offer price</i> and (b) increased using the applicable percentage rate in table 13.12.3A.
(18) Deficiency in <i>subsidiary</i>	Include as a liability the amount by which the liabilities of any <i>subsidiary</i> (excluding its capital and reserves) exceed its tangible assets. This requirement applies only to the extent that the <i>firm</i> has not already made such a provision elsewhere in its financial statements.
(19) Liability for tax	Include as a liability a provision for taxation on the whole of the profits of the <i>firm's</i> business up to its balance sheet date.
(20) Creditors relating to Unsettled <i>Securities</i> Transactions -Cash against Documents	Include creditors where the <i>firm</i> has entered into a transaction on its own behalf in <i>securities</i> or <i>units in collective investment schemes</i> on a cash against documents basis, and the transaction remains unsettled, after adding an amount calculated by (a) computing the difference between the agreed settlement price for those <i>investments</i> and their current <i>market value</i> where that difference is not in the <i>firm's</i> favour, and (b) multiplying that difference by the applicable percentage specified in table 13.12.3B.
(21) Creditors relating to Unsettled <i>Securities</i> Transactions -Free Deliveries	Include an amount for creditors where (acting on the <i>firm's</i> own behalf) the <i>firm</i> has delivered certificates of title for <i>securities</i> or <i>units in collective investment schemes</i> before receiving payment for them, or where a <i>firm</i> has bought such <i>investments</i> before receiving certificates of good title for them, as follows: (a) (if the <i>firm</i> has paid for them and not more than 3 days have passed since the payment was made) include in full: (b) (if more than 3 days have passed since the payment was made) include the full value of the <i>securities</i> at their current <i>offer price</i> .

(22) <i>Over the counter derivatives</i>	If the <i>firm</i> holds positions in <i>derivatives</i> on its own behalf must (a) make the adjustment in item (17) of this table, and (b) deduct the credit equivalent of those positions computed in accordance with table 13.12.3C. In addition, bought <i>OTC options</i> and covered <i>warrants</i> will be subject to table 13.12.3D.
(23) Contingent Liabilities	A <i>firm</i> must include a provision for any contingent liabilities which exist at its balance sheet date that must be made.
(24) Redeemable Preference Shares	Include as a liability any redeemable preference <i>shares</i> which fall due within two years. If <i>shares</i> are not redeemable by the shareholder within 2 years, they must be treated in accordance with <i>rules</i> 13.12.5 and 13.12.5A.
(25) Foreign currency risk	If the <i>firm</i> holds positions on its own behalf in foreign currencies or has assets or liabilities denominated in foreign currencies, the <i>firm</i> must calculate a provision to cover the risk in accordance with table 13.12.3D and include the amount as a liability
(26) All other liabilities	Include in full.

Table 13.12.3(2) Part I

This table forms part of *rule* 13.12.3

FIRMS IN CATEGORIES B2 AND B3 (except low resource firms)	
CALCULATION OF ASSETS	
ASSETS	ADJUSTMENTS
(1) Land and buildings	Include land and buildings which are not subject to any charge only if they have been valued either (a) at 60% of their net book value, or (b) (if valued by an independent professional valuer within the past three years) at 60% of the amount certified by the valuer to be the <i>market value</i> .

(2) Motor vehicles	<p>(a) Include motor vehicles acquired less than 12 months ago valued at 50% of their cost</p> <p>(b) Include motor vehicles acquired within the past 24 months (but more than 12 months ago) valued at 25% of their cost</p> <p>(c) Exclude in full any other motor vehicles.</p>
(3) <i>Investments</i>	<p>Include any <i>net long position</i> in any fixed or current asset investment (including <i>shares</i> in any connected company) valued at its current <i>bid price</i> (or, in the case of a with profits <i>life policy</i>, at its surrender value) and discounted by the applicable percentage specified in table 13.12.3A.</p>
(4) Debtors relating to Unsettled Securities Transactions Cash against Documents	<p>Include debtors where a <i>firm</i> has entered into a transaction on its own behalf in <i>securities</i> or <i>units in collective investment schemes</i> on a cash against documents basis and the transaction remains unsettled after deducting an amount calculated by</p> <p>(a) computing the difference between the agreed settlement price for those <i>investments</i> and their current <i>bid price</i> where that difference is not in the <i>firm's</i> favour and</p> <p>(b) multiplying that difference by the applicable percentage specified in table 13.12.3B.</p>
(5) Debtors relating to Unsettled Securities Transactions Free Deliveries	<p>(a) Where the <i>firm</i> has delivered <i>securities</i> or <i>units in collective investment schemes</i> before receiving payment for them or paid for such <i>investments</i> before receiving certificates of good title for them include the full amount due to a <i>firm</i> from debtors so long as not more than 3 days have passed since delivery.</p> <p>(b) Exclude in full if more than 3 days have passed since delivery.</p>
(6) <i>Regulated collective investment schemes</i>	<p>Include an amount owing in respect of a transaction in <i>units</i> in a <i>regulated collective investment scheme</i> only if the amount has been due and unpaid for not more than 90 days after the settlement date of the transaction to which it relates.</p>
(7) Debts of <i>group</i> or <i>connected companies</i>	<p>Include amounts due from <i>group</i> or <i>connected companies</i> (which do not relate to trade debts) where a <i>firm</i> has no reason to doubt that repayment will be made in full on demand.</p>

(8) Trade debtors	Include amounts due from trade debtors (including <i>group</i> or <i>connected companies</i>) which have been due and unpaid for less than 90 days.
(9) Prepayments	Include prepayments which relate to goods or services to be received or performed within 90 days.
(10) Accrued income	(a) Include accrued income not yet due and payable in respect of fees earned in the performance of <i>investment management</i> services that is receivable within six months. (b) Include any other accrued income receivable within 90 days.
(11) <i>Deposits</i>	Include amounts in respect of (a) cash and balances on current accounts and on <i>deposit</i> accounts with an <i>approved bank</i> or National Savings Bank which can be withdrawn within 90 days; (b) money on <i>deposit</i> with a UK local authority which can be withdrawn within 90 days; (c) money <i>deposited</i> and evidenced by a certificate of tax <i>deposit</i> .
(12) Other amounts due from Government bodies or local authorities	Include other amounts due from UK Government bodies or local authorities if they are agreed and due within 90 days.
(13) All other assets	Exclude in full.

Table 13.12.3(2) Part II

This table forms part of *rule 13.12.3*

FIRMS IN CATEGORIES B2 AND B3 (except low resource firms)	
CALCULATION OF LIABILITIES	
LIABILITIES	CALCULATIONS
(14) Secured Liabilities	<p>Include in full, except the amount of the liabilities secured by a charge on land and buildings which may be reduced as follows:</p> <p>(a) If the liabilities secured exceed 85% of the value of the land and buildings, then the excess is treated as a liability;</p> <p>(b) If the land and buildings have been valued by an independent professional valuer within the past three years, the value of the land and buildings is the amount certified by the valuer as their <i>market value</i>; otherwise it is their net book value.</p> <p>(If 60% of the value of the land and buildings which are subject to a charge exceeds the liabilities secured, then the amount of that excess may be treated as an asset.)</p>
(15) Subordinated loans	<p>Include in full, except any short term subordinated loan in the standard form prescribed by the <i>FSA</i> for such loans which may be treated as capital up to the limits specified in <i>rules 13.12.5 and 13.12.5A</i>.</p>
(16) Commission on indemnity terms from the sale of <i>life policies</i> or <i>pension contracts</i>	<p>Include as a liability a provision for repayment, in the event that premiums cease within the indemnity period, which must equal or exceed 2.5% of the commissions the <i>firm</i> has received on indemnity terms during the previous twelve months. This provision must be reasonable having regard to its circumstances and, in particular, its previous lapse ratio.</p>
(17) Short Positions	<p>Include a <i>net short position</i></p> <p>(a) valued at its <i>offer price</i>, and</p> <p>(b) increased using the applicable percentage rate in table 13.12.3A.</p>

(18) Deficiency in <i>subsidiary</i>	Include as a liability the amount by which the liabilities of any <i>subsidiary</i> (excluding its capital and reserves) exceed its tangible assets. This requirement applies only to the extent that the <i>firm</i> has not already made such a provision elsewhere in its financial statements.
(19) Liability for tax	Include as a liability a provision for taxation on the whole of the profits of its business up to its balance sheet date.
(20) Unsettled <i>Securities</i> Transactions - Cash against Documents	<p>Include creditors where the <i>firm</i> has entered into a transaction on its behalf in <i>securities</i> or <i>units in collective investment schemes</i> on a cash against documents basis, and the transaction remains unsettled, after adding an amount calculated by</p> <p>(a) computing the difference between the agreed settlement price for those <i>investments</i> and their current <i>market value</i>, and</p> <p>(b) multiplying that difference by the applicable percentage specified in table 13.12.3B.</p>
(21) Creditors relating to Unsettled <i>Securities</i> Transactions - Free Deliveries	<p>Include an amount for creditors where (acting on its behalf) the <i>firm</i> has delivered certificates of title for <i>securities</i> or <i>units in collective investment schemes</i> before receiving payment for them, or where the <i>firm</i> has bought such <i>investments</i> before receiving certificates of good title for them, as follows:</p> <p>(a) (if the <i>firm</i> has paid for them and not more than 3 days have passed since the payment was made) include in full;</p> <p>(b) (if more than 3 days have passed since the payment was made) include the full value of the <i>securities</i> at the current <i>offer price</i>.</p>
(22) <i>Over the counter derivatives</i>	Include as a liability an amount for any positions the <i>firm</i> holds on its own behalf in such <i>derivatives</i> calculated by computing the credit equivalent of those positions in accordance with table 13.12.3C. In addition, bought <i>OTC derivatives</i> and covered <i>warrants</i> will be subject to table 13.12.3D.
(23) Contingent Liabilities	A <i>firm</i> must include a provision for any contingent liabilities which exist at its balance sheet date that must be made.

(24) Long term liabilities	Include as a liability any amount which falls due more than 3 years from the balance sheet date and is due to <i>connected persons</i> , in accordance with <i>rules</i> 13.12.5 and 13.12.5A.
(25) Redeemable Preference Shares	Include as a liability any redeemable preference <i>shares</i> which fall due within two years. If <i>shares</i> are not redeemable by the shareholder within two years, they must be treated in accordance with <i>rules</i> 13.12.5 and 13.12.5A.
(26) <i>Net open foreign currency position</i>	A <i>firm</i> must calculate its foreign exchange risk requirement in accordance with table 13.12.3D and include the amount as a liability.
(27) All other liabilities	Include in full.

TABLE 13.12.3A

This table forms part of rule 13.12.3

DISCOUNTS FOR INVESTMENTS	
The percentages in the table are applied to the <i>market value</i> (unless otherwise stated) or gross positions, i.e. both longs and shorts in each category; netting and offsetting are prohibited. The long or short position in a particular investment is the net of any long or short positions held in that same investment.	
Investment	Discount
A. Debt	
UK Government or local authority stocks:	
- with less than one year to final redemption	2%
- with more than one year but less than five years to final redemption	5%
- with five years or more to final redemption	10%
Debt security:	
- debt instruments issued or accepted by an <i>approved bank</i> with less than 90 days to final redemption	2%

-	other debt instruments which are <i>marketable investments</i> with less than one year to final redemption	5%
-	other debt instruments which are <i>marketable investments</i> with less than five years to final redemption	10%
-	other debt instruments which are <i>marketable investments</i>	15%
-	floating rate notes which are <i>marketable investments</i> :	
-	with no more than 20 years to final redemption	5%
-	with more than 20 years to final redemption	10%
B.	Equities	
-	other <i>investments</i> listed on a recognised or designated investment exchange	25%
-	<i>shares</i> traded on a recognised or designated investment exchange	35%
-	other <i>shares</i> for which there is a <i>market maker</i> in the UK	35%
C.	<i>Derivatives</i>	
-	<i>exchange traded futures</i>	4 x initial margin requirement
-	<i>OTC futures</i>	Apply the appropriate percentage shown in A and B to the <i>market value</i> of the underlying position
-	Purchased <i>options</i>	Apply the appropriate percentage shown in A and B to the <i>market value</i> of the underlying position but the result may be limited to the <i>market value</i> of the option
-	<i>Contracts for differences</i>	20% of the <i>market value</i> of the contract

D.	<i>Other Investments</i>		
-	<i>Unit linked bonds and units in authorised unit trust schemes (other than higher volatility funds and property funds) or regulated collective investment schemes</i>	25%	
-	<i>units in higher volatility funds and property funds</i>	50%	
-	<i>with profit life policies (only applicable to firms other than traded life policy market makers)</i>	20%	of the surrender value of the policy
-	<i>shares in subsidiary companies and shares which are not readily realisable securities in connected companies</i>	100%	
-	<i>traded endowment policies:</i>		
	<i>where a traded life policy is held for resale by a firm which is a traded life policy market maker:</i>		
	(a) for 3 months or less	0%	of the surrender value of the policy
	(b) for more than 3 months	10%	of the surrender value of the policy
	<i>when a traded life policy is held by a firm which is a traded life policy market maker for investment</i>	10%	of the surrender value of the policy
-	<i>other</i>	100%	

TABLE 13.12.3B**This table forms part of rule 13.12.3**

UNSETTLED SECURITIES TRANSACTIONS		
Number of <i>business days</i> after due settlement date	A %	B %
0 – 15	0	0
16 – 30	25	0
31 – 45	50	25
46 – 60	75	50
61 or more	100	75
over 90	100	100
<p>Note 1 Column A applies to a transaction in a debt or debt-related instrument (unless the debt instrument is settled through the appropriate UK settlement system), and</p> <p>Note 2 Column B applies in all other cases (and, in particular, applies to equity and equity-related instruments).</p>		

TABLE 13.12.3C**This table forms part of rule 13.12.3**

OVER THE COUNTER DERIVATIVES		
a. By attaching current <i>market values</i> to contracts (marking to market), obtain the current replacement cost of all contracts with positive values.		
b. To obtain a figure for potential future credit exposure (except in the case of single currency “floating/floating interest rate swaps” in which only the current replacement costs will be calculated), the notional principal amounts or values underlying the <i>firm's</i> aggregate positions are multiplied by the following percentages:		
Residual Maturity	Interest Rate Contracts	Foreign Exchange Contracts
One year or less	Nil	1%
More than 1 year	0.5%	5%
c. The credit equivalent is the sum of current replacement cost and potential future credit exposure.		

TABLE 13.12.3D

This table forms part of rule 13.12.3

FOREIGN EXCHANGE RISK	
(a)	<p>A <i>firm</i> must deduct a foreign exchange risk requirement for all the following items which are denominated in a foreign currency:</p> <ul style="list-style-type: none">(i) all assets and liabilities, including accrued interest, denominated in the currency (all <i>investments</i> at market or realisable value);(ii) any currency future, at the nominal value of the contract;(iii) any forward contract for the purchase or sale of the currency, at the contract value, including any future exchange of principal associated with currency swaps;(iv) any foreign currency <i>options</i> at the net delta (or delta-based) equivalent of the total book of such <i>options</i>;(v) any non-currency option, at <i>market value</i>;(vi) any irrevocable guarantee;(vii) any other off-balance sheet commitment to purchase or sell an asset denominated in that currency.
(b)	<p>The requirement must be calculated as follows:</p> <ul style="list-style-type: none">(i) using the spot rate, convert the <i>net long position</i> and <i>net short position</i> in each foreign currency into the currency in which the <i>firm's annual financial statements</i> are reported;(ii) total the <i>net open long positions</i> and the <i>net open short positions</i>;(iii) the higher of (i) and (ii) above is its <i>net open foreign currency position</i>;(iv) multiply its <i>net open foreign currency position</i> by 10%;

- (c) A *firm* may not include any future income or expense not yet accrued but fully hedged (subject to deduction of an appropriate risk requirement).

13.12.4 **SHORT TERM SUBORDINATED LOANS**

13.12.4 R A *Category B firm* may treat subordinated loan as a financial resource, as specified in *rules 13.12.5 to 5A*, if the short term subordinated loan is eligible for such treatment in accordance with *rule 13.12.4A*;

13.12.4A R A short term subordinated loan is eligible for such treatment if:

- (1) it has an original maturity of at least two years or, if it has no fixed term, it is subject to two years' notice of repayment;
- (2) payment of interest is not permitted under the loan agreement unless after such payment a *firm* meet 120% of its financial resource requirement;
- (3) repayment, prepayment or termination is only permitted under the loan agreement
 - (a) on maturity, or on expiration of the period of notice, if after such payment or termination a *firm* meets 120% of its financial resources requirement; or
 - (b) on winding up after the claims of all other creditors and all outstanding debts have been settled;
- (4) it is in the standard form for short term subordinated loans prescribed by the *FSA*.

RESTRICTIONS

13.12.5 R A *Category B firm* must calculate:

- (1) the aggregate amount of its short term subordinated loans, its preference *shares* which are not redeemable within two years, and for a *Category B firm* other than a *Category B1 firm* its long term liabilities which are not secured on its assets, if they do not fall due more than three years from the balance sheet date, and are not due to *connected persons*;
- (2) the amount of the *firm's* total capital and reserves excluding preference *share* capital, less the amount of its intangible assets, multiplied by 400%.

13.12.5A R **A *Category B firm* must treat as a liability in the calculation of its financial resources any amount by which the sum of 13.12.5(1) exceeds the product of 13.12.5(2).**

APPENDIX 13 (1)

Defined terms for Chapter 13

If a defined term does not appear in the IPRU(INV) 13 glossary below, the definition appearing in the main Handbook *Glossary* applies.

50% controller	a <i>controller</i> in whose case the relevant percentage of shares or <i>voting power</i> is 50% or more.
accepting deposits	the <i>regulated activity</i> , specified in article 5 of the <i>Regulated Activities Order</i> (Accepting deposits), which is in summary: accepting deposits if: (a) money received by way of <i>deposit</i> is lent to others; or (b) any other activity of the <i>person</i> accepting the <i>deposit</i> is financed, wholly or to a material extent, out of the capital of or interest on money received by way of <i>deposit</i> .
Act	the Financial Services and Markets Act 2000.
adviser	an individual who is: (a) a <i>financial adviser</i> ; or (b) a <i>representative</i> ; or (c) an <i>appointed representative</i> .
advising on investments	the <i>regulated activity</i> , specified in article 53 of the <i>Regulated Activities Order</i> (Advising on investments), which is in summary: advising a <i>person</i> if the advice is: (a) given to the <i>person</i> in his capacity as an investor or potential investor, or in his capacity as agent for an investor or a potential investor; and (b) advice on the merits of his doing any of the following (whether as principal or agent): (i) <i>buying, selling, subscribing for or underwriting a particular investment</i> which is a <i>security</i> or a <i>contractually based investment</i> , or (ii) exercising any right conferred by such an <i>investment</i> to <i>buy, sell, subscribe for or underwrite</i> such an <i>investment</i> .
affiliated company	in relation to a <i>person</i> , an <i>undertaking</i> in the same <i>group</i> as that <i>person</i> .
affiliated persons	(a) persons who constitute a single risk because one of them has direct or indirect control over the other or others; (b) other persons who are so interconnected that, if one of them were to experience financial problems, the other or all of the others would be likely to encounter repayment difficulties;
allocation period	a single 24-hour period or, with the agreement of each <i>intermediate customer</i> concerned, a period spanning five consecutive <i>business days</i> , during which an aggregated <i>series of transactions</i> , to achieve one investment decision or objective, may be <i>executed</i> .
ancillary activity	an activity that is not a <i>regulated activity</i> but is: (a) carried on in connection with a <i>regulated activity</i> ; or

(b) held out as being for the purposes of a *regulated activity*.

annual accounting reference date the date to which a corporate *firm's* accounts are prepared for the purposes of the Companies Acts, or, where the *firm* is not subject to the Companies Acts, the equivalent date chosen by the *firm* and notified to the *FSA*;

annual financial statement the financial statements in respect of the year ending on the *firm's annual accounting reference date*;

appointed representative (in accordance with section 39 of the *Act*) a *person* (other than an *authorised person*) who:

(a) is a party to a contract with an *authorised person* (his *principal*) which:

- (i) permits or requires him to carry on business of a description prescribed in the Financial Services and Markets Act 2000 (Appointed Representatives) Regulations 2001 (SI 2001/1217); and
- (ii) complies with such requirements as are prescribed in those Regulations; and

(b) is someone for whose activities in carrying on the whole or part of that business his *principal* has accepted responsibility in writing;

and who is therefore an *exempt person* in relation to any *regulated activity* comprised in the carrying on of that business for which his *principal* has accepted responsibility.

appropriate personal pension a *personal pension policy* or a *personal pension contract* under which contributions are made to a *personal pension scheme* which is an appropriate scheme under section 1(8) of the Social Security Act 1986 or article 3(8) of the Social Security (Northern Ireland) Order 1986.

approved bank (in relation to a bank account opened by a *firm*):

(a) if the account is opened at a branch in the *United Kingdom*:

- (i) the Bank of England; or
- (ii) the central bank of a member state of the *OECD*; or
- (iii) a *bank*; or
- (iv) a *building Society* which offers, unrestrictedly, banking services; or
- (v) a bank which is supervised by the central bank or other banking regulator of a member state of the *OECD*; or

(b) if the account is opened elsewhere:

- (i) a bank in (a); or
- (ii) a *credit institution* established in an *EEA State* other than the *United Kingdom* and duly authorised by the relevant *Home State regulator*; or
- (iii) a bank which is regulated in the Isle of Man or the Channel Islands; or

(c) a bank supervised by the South African Reserve Bank; or

(d) any other bank that:

- (i) is subject to regulation by a national banking regulator;
- (ii) is required to provide audited accounts;

	(iii) has minimum net assets of £5million (or its equivalent in any other currency at the relevant time) and has a surplus revenue over expenditure for the last two financial years; and
	(iv) has an annual audit report which is not materially qualified.
approved collateral	any form of security for the discharge of any liability arising from a <i>contingent liability investment</i> (other than a guarantee) which: <ul style="list-style-type: none"> (a) (in relation to an <i>on-exchange</i> transaction) is acceptable under the rules of the relevant exchange or <i>clearing house</i>; and (b) (in relation to an <i>OTC</i> transaction) would be acceptable for a similar transaction to the relevant exchange or <i>clearing house</i>.
approved depositary	any <i>depository</i> that: <ul style="list-style-type: none"> (a) is subject to regulation by a national <i>regulatory body</i>; (b) is required to provide audited accounts; (c) has minimum net assets of £5 million (or its equivalent in any other currency at the relevant time) and has a surplus revenue over expenditure for the last two financial years; and (d) has an annual audit report which is not materially qualified.
arranging (bringing about) deals in investments	the <i>regulated activity</i> , specified in article 25(1) of the <i>Regulated Activities Order</i> , which is, in summary: making arrangements for another <i>person</i> (whether as <i>principal</i> or agent) to <i>buy, sell, subscribe for or underwrite</i> a particular <i>investment</i> which is: <ul style="list-style-type: none"> (a) a <i>designated investment</i>; or (b) the <i>underwriting capacity of a Lloyd's syndicate</i>; or (c) <i>membership of a Lloyd's syndicate</i>; or (d) rights to or interests in <i>investments</i> in (b) or (c).
associate	(in relation to a <i>person</i> ("A")): <ul style="list-style-type: none"> (a) an <i>affiliated company</i> of A; (b) an <i>appointed representative</i> of A or of any <i>affiliated company</i> of A; (c) any other <i>person</i> whose business or domestic relationship with A or his <i>associate</i> might reasonably be expected to give rise to a community of interest between them which may involve a conflict of interest in dealings with third parties.
AUT	an <i>authorised unit trust scheme</i> .
authorised corporate director	the <i>director</i> of an <i>ICVC</i> who is the authorised corporate director of the <i>ICVC</i> in accordance with <i>COLL 6.5.3R</i> (Appointment of an ACD) or, as the case may be, <i>CIS 7.2.1R</i> (The directors).
authorised fund	an <i>ICVC</i> or an <i>AUT</i> .
authorised person	(in accordance with section 31 of the <i>Act</i> (Authorised persons)) one of the following: <ul style="list-style-type: none"> (a) a <i>person</i> who has a <i>Part IV permission</i> to carry on one or more <i>regulated activities</i>; (b) an <i>incoming EEA firm</i>; (c) an <i>incoming Treaty firm</i>; (d) a <i>UCITS qualifier</i>; (e) an <i>ICVC</i>.

	(f) the <i>Society</i> of Lloyds
authorised unit trust scheme	(as defined in section 237(3) of the <i>Act</i> (Other definitions)) a <i>unit trust scheme</i> which is authorised for the purposes of the <i>Act</i> by an <i>authorisation order</i> .
bearer form	(in relation to a <i>client's</i> certificate, <i>share</i> transfer or other <i>document</i>) in a form signed by the <i>client</i> so that it enables a <i>designated investment</i> or <i>deposit</i> to which it relates to be sold, transferred, surrendered or dealt with in any other way without the need to obtain further written instructions and allowing the <i>firm</i> access to the sale proceeds.
bid price	the <i>price</i> at which a <i>person</i> could sell a <i>unit</i> in a <i>dual-priced AUT</i> or a <i>security</i> .
body corporate	(in accordance with section 417(1) of the <i>Act</i> (Definitions)) any body corporate, including a body corporate constituted under the law of a country or territory outside the <i>United Kingdom</i> .
bonded investment	<p>a <i>designated investment</i> not held by a <i>trustee</i> when acting as a <i>trustee</i>:</p> <ul style="list-style-type: none"> (i) which the <i>firm</i> may <i>sell</i> or procure the sale of without the signature or other action of the <i>customer</i> or an independent third party; (ii) where the proceeds of such a sale are or could be payable to the <i>firm</i> or a <i>connected person</i>; and (iii) which, other than in the case of a <i>unit</i> in a <i>collective investment scheme</i>, is one of the following: <ul style="list-style-type: none"> (a) a <i>readily realisable security</i> held for a <i>customer</i> whether or not held under a discretionary arrangement; or (b) a bearer <i>designated investment</i>; or (c) a <i>designated investment</i> held by a <i>nominee company</i> under the <i>control</i> of the <i>firm</i> or a <i>person</i> whom the <i>firm</i> controls; or <p>a <i>designated investment</i> to which the title is recorded in electronic form</p>
branch	<ul style="list-style-type: none"> (a) in relation to a <i>credit institution</i>: <ul style="list-style-type: none"> (i) a place of business which forms a legally dependent part of a <i>credit institution</i> and which carries out directly all or some of the transactions inherent in the business of <i>credit institutions</i>; (ii) for the purposes of the <i>Banking Consolidation Directive</i>, any number of places of business set up in the same <i>EEA State</i> by a <i>credit institution</i> with headquarters in another <i>EEA State</i> are to be regarded as a single <i>branch</i>; (b) in relation to an <i>investment firm</i>, <ul style="list-style-type: none"> (i) a place of business which is a part of an <i>investment firm</i>, not being the principal place of business, which has no separate legal personality and which provides <i>investment services</i> for which the <i>investment firm</i> has been authorised; (ii) for the purposes of the <i>Investment Services Directive</i>, all the places of business set up in the same <i>EEA State</i> by an <i>investment firm</i> with headquarters in another <i>EEA State</i> are to be regarded as a single <i>branch</i>; (c) in relation to an <i>insurance undertaking</i>, any permanent presence of the <i>insurance undertaking</i> in an <i>EEA State</i> other than that in which it has its head office is to be regarded as a single <i>branch</i>, whether that presence consists of a single office which, or two or more offices each of which: <ul style="list-style-type: none"> (i) is managed by the <i>insurance undertaking's</i> own staff; or

	(ii) is an agency of the <i>insurance undertaking</i> ; or
	(iii) is managed by a <i>person</i> who is independent of the <i>insurance undertaking</i> , but has permanent authority to <i>act</i> for the <i>insurance undertaking</i> as an agency would.
broker fund	(in relation to a fund for which the <i>firm</i> is or will be a <i>broker fund adviser</i>): (a) an actual or notional fund of a <i>long-term insurer</i> , which contains or will contain contributions made or to be made by a <i>client</i> or <i>clients</i> of a <i>firm</i> in connection with a <i>life policy</i> or <i>policies</i> ; (b) a fund of a <i>collective investment scheme</i> , which contains or will contain cash contributions made or to be made by a <i>client</i> or <i>clients</i> of a <i>firm</i> in connection with the purchase of <i>units</i> in the <i>scheme</i> .
broker fund adviser	a <i>person</i> who has, or whose <i>associate</i> being an <i>authorised person</i> has, an arrangement with a <i>long-term insurer</i> , or with the <i>operator</i> of a <i>regulated collective investment scheme</i> or an <i>unregulated collective investment scheme</i> , under which it is to be expected that the <i>long-term insurer</i> or <i>operator</i> will take into account the advice of that <i>person</i> or his <i>associate</i> : (a) in the case of a <i>long-term insurer</i> , on any matter likely to influence the performance of any of the <i>long-term insurer's</i> funds or of any <i>investment</i> issued by the <i>long-term insurer</i> into which cash contributions of that <i>person's customers</i> have been made; (b) in the case of an <i>operator</i> , on the composition of the property of the <i>collective investment scheme</i> into which cash contributions of that <i>person's customers</i> have been made; in this definition, <i>associate</i> includes any <i>authorised person</i> in respect of whose services the first <i>person</i> receives any benefit or reward, either directly or indirectly, in connection with advice of the kind described in (a) and (b) given to a <i>long-term insurer</i> or to a <i>collective investment scheme operator</i> .
building society	(as defined in section 119(1) of the Building Societies Act 1986) a building society incorporated (or deemed to be incorporated) under that Act.
business day	(1) (in relation to anything done or to be done in any part of the <i>United Kingdom</i>): (a) (except in REC) any <i>day</i> which is not a Saturday or Sunday, Christmas Day, Good Friday or a bank holiday in that part of the <i>United Kingdom</i> ; (b) (in REC) (as defined in section 167 of the Companies Act 1989) any <i>day</i> which is not a Saturday or Sunday, Christmas Day, Good Friday or a bank holiday in any part of the <i>United Kingdom</i> . (2) (in relation to anything done or to be done by reference to a market outside the <i>United Kingdom</i>) any <i>day</i> on which that market is normally open for business.
buying	(in accordance with article 3(1) of the <i>Regulated Activities Order</i> (Interpretation general)) any form of buying, including acquiring for valuable consideration.
Category A firm	a <i>personal investment firm</i> which is an <i>ISD investment firm</i> ;
Category A1 firm	a <i>Category A firm</i> whose <i>permission</i> includes <i>dealing in investments as principal</i> ;
Category A2 firm	a <i>Category A firm</i> whose <i>permission</i> does not include <i>dealing in investments as principal</i> ; and which is not subject to a <i>requirement</i> preventing the holding or controlling of <i>client money</i> or <i>custody assets</i> .

Category A3 firm	a <i>Category A firm</i> whose <i>permission</i> includes only <i>insurance mediation activity</i> in relation to <i>non-investment insurance contracts</i> , <i>mortgage mediation activity</i> , <i>assisting in the administration and performance of contracts of insurances</i> , <i>arranging transactions in investments</i> , <i>advising on investments</i> and <i>managing investments</i> but which is subject to a <i>requirement</i> not to hold or control <i>client money</i> or <i>custody assets</i>
Category B firm	a <i>personal investment firm</i> , other than a <i>Category A firm</i> ;
Category B1 firm	a <i>Category B firm</i> whose <i>permission</i> includes <i>dealing in investments as principal</i> ;
Category B2 firm	a <i>Category B firm</i> whose <i>permission</i> does not include <i>dealing as principal</i> ; and is not subject to a <i>requirement</i> preventing the holding or controlling of <i>client money</i> or <i>custody assets</i> .
Category B3 firm	a <i>Category B firm</i> whose <i>permission</i> includes only <i>insurance mediation activity</i> in relation to <i>non-investment insurance contracts</i> , <i>home finance mediation activity</i> , <i>assisting in the administration and performance of contracts of insurances</i> , <i>arranging transactions in life policies</i> and other <i>insurance contracts</i> , <i>advising on investments</i> and receiving and transmitting, on behalf of investors, orders in relation to <i>securities</i> and <i>units in collective investment schemes</i> ; but which is subject to a <i>requirement</i> not to hold or control <i>client money</i> or <i>custody assets</i> .
charge	any <i>fee</i> or charge made to a <i>client</i> in connection with <i>designated investment business</i> , whether levied by the <i>firm</i> or any other <i>person</i> , including a <i>mark-up</i> or <i>mark-down</i> .
clearing firm	a <i>firm</i> which assumes primary responsibility (including legal liability) for the <i>execution</i> and settlement of transactions for <i>clients</i> .
clearing house	a clearing house through which transactions on an exchange may be cleared.
client	any <i>person</i> with or for whom a <i>firm</i> conducts or intends to conduct <i>designated investment business</i> or any other <i>regulated activity</i> ; and: <ul style="list-style-type: none"> (a) every client is a <i>customer</i> or a <i>market counterparty</i>; (b) "client" includes: <ul style="list-style-type: none"> (i) a potential client; (ii) a client of an <i>appointed representative</i> of a <i>firm</i> with or for whom the <i>appointed representative</i> acts or intends to act, in the course of business for which the <i>firm</i> has accepted responsibility under section 39 of the <i>Act</i> (Exemption of appointed representatives); (iii) a <i>collective investment scheme</i> even if it does not have separate legal personality; (iv) if a <i>person</i> ("C1"), with or for whom the <i>firm</i> is conducting or intends to conduct <i>designated investment business</i>, is acting as agent for another <i>person</i> ("C2"), either C1 or C2 in accordance with COB 4.1.5R (Agent as client); (c) "client" does not include: <ul style="list-style-type: none"> (i) a trust beneficiary; (ii) a <i>corporate finance contact</i>; <p>a <i>venture capital contact</i>.</p>
client agreement	<i>terms of business</i> which have been signed by the <i>client</i> or to which the <i>client</i> has consented in writing.

client asset rules	CASS, including the <i>custody rules</i> , <i>client money rules</i> , <i>mandate rules</i> and <i>collateral rules</i> .
client bank account	(a) an account at a bank which: <ul style="list-style-type: none"> (i) holds the <i>money</i> of one or more <i>clients</i>; (ii) is in the name of the <i>firm</i>; (iii) includes in its title an appropriate description to distinguish the <i>money</i> in the account from the <i>firm's money</i>; and (iv) is a current or a deposit account; or (b) a money market deposit of <i>client money</i> which is identified as being <i>client money</i> .
client money	subject to the <i>client money rules</i> , <i>money</i> of any currency which, in the course of carrying on <i>designated investment business</i> , a <i>firm</i> holds in respect of any <i>investment agreement</i> entered into, or to be entered into, with or for a <i>client</i> , or which a <i>firm</i> treats as <i>client money</i> in accordance with the <i>client money rules</i> .
client money distribution rules	CASS 4.4.
client money rules	CASS 4.1 to 4.3.
client transaction account	(in relation to a <i>firm</i> and an exchange or <i>clearing house</i> or an <i>intermediate broker</i>) an account maintained by the exchange, <i>clearing house</i> or the <i>intermediate broker</i> , as the case may be, in respect of contingent liability <i>transactions</i> undertaken by the <i>firm</i> with or for its <i>clients</i> .
close relative	(as defined in article 3(1) of the <i>Regulated Activities Order</i>) (in relation to any <i>person</i>): <ul style="list-style-type: none"> (a) his spouse or civil partner; (b) his children and step-children, his parents and step-parents, his brothers and sisters and his step-brothers and step-sisters; and (c) the spouse or civil partner of any <i>person</i> within (b).
collateral	any of the following: <ul style="list-style-type: none"> (a) an <i>investment</i> specified in articles 76 to 81 of the <i>Regulated Activities Order</i>, that is: <ul style="list-style-type: none"> (i) <i>shares</i> (article 76); (ii) <i>debentures</i> (article 77); (iii) <i>government and public securities</i> (article 78); (iv) <i>warrants</i> (article 79); (v) <i>certificates representing certain securities</i> (article 80); (vi) <i>units</i> (article 81); or (b) <i>money</i>; or (c) a <i>commodity warrant</i> (however title is recorded or evidenced); which belongs to a <i>client</i> and which is held or controlled by the <i>firm</i> under the terms of a deposit, pledge, charge or other security arrangement.
collective investment scheme	a collective investment scheme, as defined in section 235 of the <i>Act</i> (Collective Investment Schemes), which is in summary: <ul style="list-style-type: none"> (a) any arrangements with respect to property of any description, including

money, the purpose or effect of which is to enable *persons* taking part in the arrangements (whether by becoming owners of the property or any part of it or otherwise) to participate in or receive profits or income arising from the acquisition, holding, management or disposal of the property or sums paid out of such profits or income; and

(b) which are not excluded by the Financial Services and Markets Act (Collective Investment Schemes) Order 2001 (SI 2001/1062).

commencement	the beginning of the <i>commencement day</i> .
commencement day	the <i>day</i> on which section 19 of the <i>Act</i> (The general prohibition) comes into force.
commission	any form of commission, including a benefit of any kind, offered or given in connection with <i>designated investment business</i> .
commodity	a physical asset (other than a financial instrument or cash) which is capable of delivery.
company	any <i>body corporate</i> .
connected person	<p>in relation to a <i>person</i>,</p> <p>(a) its <i>controller</i>;</p> <p>(b) a partner in it, or his or its partner;</p> <p>(c) a director of it;</p> <p>(d) its employee (whether under a contract of service or a contract for services) or an employee of its <i>appointed representative</i>;</p> <p>(e) another <i>undertaking</i> having the same <i>controller</i> as that <i>person</i>;</p> <p>(f) an <i>undertaking</i> which is an <i>associate</i> of that <i>person</i>;</p> <p>(g) (if the <i>person</i> is not a <i>body corporate</i>)</p> <p style="padding-left: 20px;">(i) a <i>close relative</i> of any <i>person</i> within (a) to (d) above; or</p> <p style="padding-left: 20px;">(ii) a <i>body corporate</i> controlled by that <i>person</i> or by any partner of that <i>person</i>; or</p> <p>(h) a trustee of a trust (other than an <i>occupational pension scheme</i>) the beneficiaries of which the <i>firm</i> knows or ought to know include any individual within (a) to (d) or (g)(i) above.</p>
contingent liability investment	a <i>derivative</i> under the terms of which the <i>client</i> will or may be liable to make further payments (other than <i>charges</i> , and whether or not secured by <i>margin</i>) when the transaction fails to be completed or upon the earlier <i>closing out</i> of his position.
contract for differences	<p>(as specified in article 85 of the <i>Regulated Activities Order</i> (Contracts for differences etc)) rights under:</p> <p>(a) a contract for differences; or</p> <p>(b) any other contract the purpose or pretended purpose of which is to secure a profit or avoid a loss by reference to fluctuations in:</p> <p style="padding-left: 20px;">(i) the value or price of property of any description; or</p>

contract of insurance	<p>(ii) an index or other factor designated for that purpose in the contract.</p> <p>(1) (in relation to a <i>specified investment</i>) the <i>investment</i> specified in article 75 of the <i>Regulated Activities Order</i> (Contracts of insurance) which is rights under a contract of insurance).</p> <p>(2) (in relation to a contract) (in accordance with article 3(1) of the <i>Regulated Activities Order</i> (Interpretation: general)) any contract of insurance which is a <i>long-term insurance contract</i> or a <i>general insurance contract</i>, including:</p> <p>(a) fidelity bonds, performance bonds, administration bonds, bail bonds, customs bonds or similar contracts of guarantee, where these are:</p> <p style="padding-left: 20px;">(i) effected or carried out by a <i>person</i> not carrying on a banking business;</p> <p style="padding-left: 20px;">(ii) not effected merely incidentally to some other business carried on by the <i>person</i> effecting them; and</p> <p style="padding-left: 20px;">(iii) effected in return for the payment of one or more premiums.;</p> <p>(b) <i>tontines</i>;</p> <p>(c) <i>capital redemption</i> contracts, pension fund management contracts, where these are effected or carried out by a <i>person</i> who:</p> <p style="padding-left: 20px;">(i) does not carry on a banking business; and</p> <p style="padding-left: 20px;">(ii) otherwise carries on a <i>regulated activity</i> of the kind specified by article 10 of the <i>Regulated Activities Order</i> (Effecting and carrying out contracts of insurance);</p> <p>(d) contracts to pay annuities on human life;</p> <p>(e) contracts of a kind referred to in article 1(2)(e) of the <i>First Life Directive</i> (Collective insurance etc); and</p> <p>(f) contracts of a kind referred to in article 1(3) of the <i>First Life Directive</i> (Social insurance).</p> <p>in this definition, "annuities on human life" does not include superannuation allowances and annuities payable out of any fund applicable solely to the relief and maintenance of <i>persons</i> engaged or who have been engaged, in any particular profession, trade or employment, or of the dependants of such <i>persons</i>.</p>
contractually based investment	<p>(in accordance with article 3 of the <i>Regulated Activities Order</i> (Interpretation: general)):</p> <p>(a) rights under a <i>life policy</i>;</p> <p>(b) an <i>option, future or contract for differences</i>;</p> <p>(c) <i>rights to or interests in an investment</i> falling within (a) or (b).</p>
control	<p>(in relation to the acquisition, increase or reduction of control of a <i>firm</i>) the relationship between a <i>person</i> and the <i>firm</i> or other <i>undertaking</i> of which the <i>person</i> is a <i>controller</i>.</p>
controlled activity	<p>an activity specified in Part 1 of Schedule 1 to the <i>Financial Promotion Order</i> (Controlled activities).</p>
controller	<p>(as defined in section 422 of the <i>Act</i> (Controller))</p> <p>(in relation to a <i>firm</i> or other <i>undertaking</i> ("A"))</p> <p>a person (see I) who:</p>

- (a) holds 10 % or more of the shares in A; or
- (b) is able to exercise significant influence over the management of A through his shareholding in A; or
- (c) holds 10 % or more of the shares in a *parent undertaking* ("P") of A; or
- (d) is able to exercise significant influence over the management of P through his shareholding in P; or
- (e) is entitled to exercise, or control the exercise of, 10 % or more of the *voting power* in A; or
- (f) is able to exercise significant influence over the management of A through his *voting power* in A; or
- (g) is entitled to exercise, or control the exercise of, 10 % or more of the *voting power* in P; or
- (h) is able to exercise significant influence over the management of P through his *voting power* in P;

in this definition:

- (A) "*person*" means:
 - (i) the *person*;
 - (ii) any of the *person's* associates; or
 - (iii) the *person* and any of his associates;
- (B) "*associate*", in relation to a *person* ("H") holding shares in an *undertaking* ("C") or entitled to exercise or control the exercise of *voting power* in relation to another *undertaking* ("D"), means:
 - (a) the spouse of H;
 - (b) a child or stepchild of H (if under 18);
 - (c) the trustee of any settlement under which H has a life interest in possession (or in Scotland a life interest);
 - (d) an *undertaking* of which H is a director;
 - (e) a *person* who is an employee or partner of H;
 - (f) if H is an *undertaking*:
 - (i) a director of H;
 - (ii) a *subsidiary undertaking* of H;
 - (iii) a director or employee of such a *subsidiary undertaking*; and
 - (g) if H has with any other *person* an agreement or arrangement with respect to the acquisition, holding or disposal of shares or other interests in C or D or under which they undertake to act together in exercising their *voting power* in relation to C or D, that other *person*;
- (C) "*settlement*" includes any disposition or arrangement under which property is held on trust (or subject to a comparable obligation);
- (D) "*shares*" means:
 - (a) in relation to an *undertaking* with a share capital, allotted shares;
 - (b) in relation to an *undertaking* with capital but no share capital, rights to share in the capital of the *undertaking*;
 - (c) in relation to an *undertaking* without capital, interests:
 - (i) conferring any right to share in the profits, or liability to

contribute to the losses, of the *undertaking*; or

- (ii) giving rise to any obligation to contribute to the debts or expenses of the *undertaking* in the event of a winding up.

(see also *50% controller*)

corporate finance
business

- (a) *designated investment business* carried on by a *firm* with or for:
 - (i) any *issuer, holder* or owner of *designated investments*, if that business relates to the *offer, issue, underwriting, repurchase, exchange or redemption of, or the variation of the terms of, those investments, or any related matter*;
 - (ii) any *market counterparty or intermediate customer, or other body corporate, partnership* or supranational organisation, if that business relates to the manner in which, or the terms on which, or the *persons* by whom, any business, activities or *undertakings* relating to it, or any *associate*, are to be financed, structured, managed, controlled, regulated or reported upon;
 - (iii) any *person* in connection with:
 - (A) a proposed or actual *takeover or related operation* by or on behalf of that *person*, or involving *investments* issued by that *person* (being a *body corporate*), its *holding company, subsidiary* or *associate*; or
 - (B) a merger, de-merger, reorganisation or reconstruction involving any *investments* issued by that *person* (being a *body corporate*), its *holding company, subsidiary* or *associate*;
 - (iv) any shareholder or prospective shareholder of a *body corporate* established or to be established for the purpose of effecting a *takeover or related operation*, where that business is in connection with that *takeover or related operation*;
 - (v) any *person* who, acting as a *principal* for his own account:
 - (A) is involved in negotiations or decisions relating to the commercial, financial or strategic intentions or requirements of a business or prospective business; or
 - (B) (provided he is acting otherwise than solely in his capacity as an investor) assists the interests of another *person* with or for whom the *firm, or another authorised person or overseas person, is undertaking business as specified in (a)(i),(ii),(iii) or (iv), by himself undertaking all or part of any transactions involved in such business*;
 - (vi) any *person* undertaking business with or for a *person* as specified in (a)(i), (ii), (iii), (iv) or (v) in respect of activities described in those sub-paragraphs;
- (b) *designated investment business* carried on by a *firm* as a *principal* for its own account where such business:
 - (i) is in the course of, or arises out of, activities undertaken in accordance with (a); and
 - (ii) does not involve transactions with or for, or *advice on investments* to, any other *person* who is a *private customer* in respect of such business;
- (c) *designated investment business* carried on by a *firm* as *principal* for its own account if such business:
 - (i) is in the course of, or arises out of:
 - (A) the *offer, issue, underwriting, repurchase, exchange or*

	<p>redemption of, or the variation of the terms of, <i>shares, share warrants, debentures or debenture warrants</i> issued by the <i>firm</i>, or any related matter; or</p> <p>(B) a proposed or actual <i>takeover or related operation</i> by or on behalf of the <i>firm</i>, or involving <i>shares, share warrants, debentures or debenture warrants</i> issued by the <i>firm</i>; or</p> <p>(C) a merger, de-merger, reorganisation or reconstruction involving any <i>shares, share warrants, debentures or debenture warrants</i> issued by the <i>firm</i>; and</p> <p>(ii) does not involve <i>advice</i> on investments to any <i>person</i> who is a <i>private customer</i>;</p> <p>in this definition, “<i>share warrants</i>” and “<i>debenture warrants</i>” mean any <i>warrants</i> which relate to <i>shares</i> in the <i>firm</i> concerned or, as the case may be, <i>debentures</i> issued by the <i>firm</i>.</p>
credit	<p>(1) (except in relation to a <i>class of contract of insurance</i>) any kind of loan, deferment of repayment of any loan or of interest on any loan, guarantee or indemnity, and any other kind of accommodation or <i>facility</i> in the nature of <i>credit</i>.</p> <p>(2) (in relation to a <i>class of contract of insurance</i>) the <i>class of contract of insurance</i>, specified in paragraph 14 of Part I of Schedule 1 to the <i>Regulated Activities Order</i> (Contracts of general insurance), against risks of loss to the <i>persons</i> insured arising from the insolvency of debtors of theirs or from the failure (otherwise than through insolvency) of debtors of theirs to pay their debts when due.</p>
custody asset	<p>(a) a <i>designated investment</i> held for or on behalf of a <i>client</i>;</p> <p>(b) any other asset which is or may be held with a <i>designated investment</i> held for, or on behalf of, a <i>client</i>.</p>
custody rules	CASS 2.
customer	<p>(1) (except in COB 3) a <i>client</i> who is not a <i>market counterparty</i>.</p> <p>(2) (in COB 3) a <i>person</i> in (1) or a <i>person</i> who would be such a <i>person</i> if he was a <i>client</i>.</p>
deal	a <i>dealing</i> transaction.
dealing	(in accordance with paragraph 2 of Schedule 2 to the <i>Act</i> (Regulated activities)) buying, selling, subscribing for or underwriting <i>investments</i> or offering or agreeing to do so, either as a <i>principal</i> or as an agent, including, in the case of an <i>investment</i> which is a <i>contract of insurance</i> , carrying out the contract.
debenture	<p>the <i>investment</i> specified in article 77 of the <i>Regulated Activities Order</i> (Instruments creating or acknowledging indebtedness), which is in summary: any of the following which are not <i>government and public securities</i>:</p> <p>(a) debentures;</p> <p>(b) debenture stock;</p> <p>(c) loan stock;</p> <p>(d) bonds;</p> <p>(e) certificates of deposit;</p> <p>(f) any other instrument creating or acknowledging indebtedness.</p>

debt capital	<p>a <i>security</i> of indeterminate duration or other instrument the debt agreement for which provides that</p> <ul style="list-style-type: none"> (a) it may not be reimbursed on the holder's initiative; (b) the borrower has the <i>option</i> of deferring the payment of interest on the debt; (c) the lender's claims on the borrower must be wholly subordinated to those of all non-subordinated creditors; (d) debt and unpaid interest should be such as to absorb losses, whilst leaving the borrower in a <i>position</i> to continue trading; <p>and which is fully paid-up;</p>
deposit	<p>the <i>investment</i>, specified in article 74 and defined in articles 5(2) and 5(3) of the <i>Regulated Activities Order</i>, which is, in summary: a sum of money (other than one excluded by any of articles 6 to 9 of the <i>Regulated Activities Order</i>) paid on terms:</p> <ul style="list-style-type: none"> (a) under which it will be repaid, with or without interest or a premium, and either on demand or at a time or in circumstances agreed by or on behalf of the <i>person</i> making the payment and the <i>person</i> receiving it; and (b) which are not referable to the provision of property (other than currency) or services or the giving of security; <p>in this definition, money is paid on terms which are referable to the provision of property or services or the giving of security if, and only if:</p> <ul style="list-style-type: none"> (a) it is paid by way of advance or part payment under a contract for the sale, hire or other provision of property or services, and is repayable only in the event that the property or services is or are not in fact sold, hired or otherwise provided; (b) it is paid by way of security for the performance of a contract or by way of security in respect of loss which may result from the non-performance of a contract; or (c) without prejudice to (b), it is paid by way of security for the delivery up or return of any property, whether in a particular state of repair or otherwise.
deposit-taking firm	a <i>firm</i> which is a <i>bank</i> , <i>building society</i> or <i>credit union</i> .
depository	<ul style="list-style-type: none"> (1) (in relation to an <i>ICVC</i>) the <i>person</i> to whom is entrusted the safekeeping of all of the <i>scheme property</i> of the <i>ICVC</i> and who has been appointed for this purpose in accordance with regulation 5 (Safekeeping of scheme property by depository) of and Schedule 1 (Depositaries) to the <i>OEIC Regulations</i>. (2) (in relation to an <i>AUT</i>) the <i>trustee</i>. (3) (in relation to any other <i>unit trust scheme</i>) the <i>person</i> holding the property of the <i>scheme</i> on trust for the <i>participants</i>. (4) (in relation to any other <i>collective investment scheme</i>) any <i>person</i> to whom the property subject to the <i>scheme</i> is entrusted for safekeeping.
derivative	a <i>contract for differences</i> , a <i>future</i> or an <i>option</i> .
designated investment	<p>a <i>security</i> or <i>contractually-based investment</i> that is any of the following <i>investments</i> specified in Part III of the <i>Regulated Activities Order</i> (Specified Investments):</p> <ul style="list-style-type: none"> (a) <i>life policy</i> (subset of article 75 (Contracts of insurance)); (b) <i>share</i> (article 76); (c) <i>debenture</i> (article 77);

- (d) *government and public security* (article 78);
- (e) *warrant* (article 79);
- (f) *certificate representing a certain security* (article 80);
- (g) *unit* (article 81);
- (h) *stakeholder pension scheme* (article 82);
- (i) *option* (article 83); (for the purposes of the *permission* regime, this is sub-divided into:
 - (i) *option* (excluding a *commodity option* and an *option* on a *commodity future*);
 - (ii) *commodity option* and an *option* on a *commodity future*);
- (j) *future* (article 84); (for the purposes of the *permission* regime, this is sub-divided into:
 - (i) *future* (excluding a *commodity future* and a *rolling spot forex contract*);
 - (ii) *commodity future*;
 - (iii) *rolling spot forex contract*;
- (k) *contract for differences* (article 85); (for the purposes of the *permission* regime, this is sub-divided into:
 - (i) *contract for differences* (excluding a *spread bet* and a *rolling spot forex contract*);
 - (ii) *spread bet*;
 - (iii) *rolling spot forex contract*;
- (l) *rights to or interests in investments* in (a) to (k) (article 89).

designated
investment
business

any of the following activities specified in Part II of the *Regulated Activities Order* (Specified Activities) which is carried on by way of business:

- (a) *dealing in investments as principal* (article 14), but disregarding the exclusion in article 15 (Absence of holding out etc);
- (b) *dealing in investments as agent* (article 21);
- (c) *arranging (bringing about) deals in investments* (article 25(1)), but only in relation to *designated investments*;
- (d) *making arrangements with a view to transactions in investments* (article 25(2)), but only in relation to *designated investments*;
- (e) *managing investments* (article 37);
- (f) *safeguarding and administering investments* (article 40); (for the purposes of the *permission* regime, this is sub-divided into:
 - (i) *safeguarding and administration of assets (without arranging)*;
 - (ii) *arranging safeguarding and administration of assets*;
- (g) *sending dematerialised instructions* (article 45(1));
- (h) *causing dematerialised instructions to be sent* (article 45(2));
- (i) *establishing, operating or winding up a collective investment scheme* (article 51(1)(a)); for the purposes of the *permission* regime, this is sub-divided into:
 - (i) *establishing, operating or winding up a regulated collective investment scheme*);

	<ul style="list-style-type: none"> (ii) <i>establishing, operating or winding up an unregulated collective investment scheme;</i> (j) <i>acting as trustee of an authorised unit trust scheme</i> (article 51(1)(b)); (k) <i>acting as the depositary or sole director of an open-ended investment company</i> (article 51(1)(c)); (l) <i>establishing, operating or winding up a stakeholder pension scheme</i> (article 52); (m) <i>advising on investments</i> (article 53); for the purposes of the <i>permission</i> regime, this is sub-divided into: <ul style="list-style-type: none"> (i) <i>advising on investments (except pension transfers and pension opt-outs);</i> (ii) <i>advising on pension transfers and pension opt-outs;</i> (n) <i>agreeing to carry on a regulated activity</i> in (a) to (h) and (m) (article 64).
designated investment exchange	any investment exchange appearing in the list at <i>IPRU(INV) 3 App 33, Part 2.</i>
EEA right	(in accordance with paragraph 7 of Schedule 3 to the <i>Act</i> (EEA Passport Rights)) the entitlement of a <i>person</i> to establish a <i>branch</i> or provide services in an <i>EEA State</i> other than that in which he has his head office: <ul style="list-style-type: none"> (a) in accordance with the <i>Treaty</i> as applied in the <i>European Economic Area</i>; and (b) subject to the conditions of the relevant <i>Single Market Directive</i>.
EEA State	(in accordance with paragraph 8 of Schedule 3 to the <i>Act</i> (EEA Passport Rights)) a State which is a contracting party to the agreement on the European Economic Area signed at Oporto on 2 May 1992, as it has effect for the time being; as at 21 June 2001, the following are the <i>EEA States</i> : Austria, Belgium, Denmark, Finland, France, Germany, Greece, Iceland, Ireland, Italy, Liechtenstein, Luxembourg, the Netherlands, Norway, Portugal, Spain, Sweden and the <i>United Kingdom</i> .
European Economic Area	the area established by the agreement on the European Economic Area signed at Oporto on 2 May 1992 and which consists of the <i>EEA States</i> .
evidential provision	a <i>rule</i> , contravention of which does not give rise to any of the consequences provided for by other provisions of the <i>Act</i> ; and which provides, in accordance with section 149(2) of the <i>Act</i> , that: <ul style="list-style-type: none"> (a) contravention may be relied on as tending to establish contravention of such other <i>rule</i> as may be specified; or (b) compliance may be relied on as tending to establish compliance with such other <i>rule</i> as may be specified; or (c) both (a) and (b).
exchange	a <i>recognised investment exchange</i> or <i>designated investment exchange</i> ;
exchange traded	listed or traded on a <i>recognised</i> or <i>designated investment exchange</i>
exempt person	(as defined in section 417(1) of the <i>Act</i> (Definitions)) (in relation to a <i>regulated activity</i>): a <i>person</i> who is exempt from the <i>general prohibition</i> in respect of that activity as a result of: <ul style="list-style-type: none"> (a) the <i>Exemption Order</i>; or (b) being an <i>appointed representative</i>; or (c) section 285(2) or (3) of the <i>Act</i> (Exemption for recognised investment

	exchanges <i>and</i> clearing houses).
Exemption Order	the Financial Services and Markets Act 2000 (Exemption) Order 2001 (SI 2001/1201).
exit charge	an amount levied by the <i>operator</i> of a <i>scheme</i> , together with any other expenses incurred, upon the redemption of <i>units</i> .
exposure	(in relation to a <i>firm</i>) the maximum loss which the <i>firm</i> might suffer if: <ul style="list-style-type: none"> (a) a counterparty or a <i>group</i> of connected counterparties fails to meet its obligations; or (b) the <i>firm</i> realises assets or off-balance sheet positions.
fee	any payment offered or made by a <i>client</i> to a <i>firm</i> in connection with <i>designated investment business</i> or with any other business of the <i>firm</i> , including (where applicable) any <i>mark-up</i> or <i>mark-down</i> .
financial adviser	an individual appointed by an <i>independent intermediary</i> or by its <i>appointed representative</i> to provide any or all of the following services: <ul style="list-style-type: none"> (a) giving <i>advice on investments</i> to <i>clients</i>; (b) <i>arranging (bringing about) deals in investments</i> or <i>executing</i> transactions involving, in each case, <i>designated investments</i> with or for <i>clients</i>; (c) <i>managing investments</i>; (d) receiving or holding <i>client money</i> or other <i>client</i> assets; (e) <i>safeguarding and administering investments</i>.
Financial Ombudsman Service Limited	the <i>body corporate</i> established by the FSA under paragraph 2(1) of Schedule 17 to the <i>Act</i> (The Scheme Operator) to administer the <i>Financial Ombudsman Service</i> .
firm	an <i>authorised person</i> , but not a <i>professional firm</i> unless it is an authorised <i>professional firm</i> .
First Life Directive	the Council Directive of 5 March 1979 on the coordination of laws, regulations and administrative provisions relating to the taking up and pursuit of the business of direct life assurance (No 79/267/EEC).
forward price	(in relation to <i>units</i>), a <i>price</i> calculated by reference to the <i>valuation point</i> next following the <i>authorised fund manager's</i> agreement to <i>sell</i> or, as the case may be, to <i>redeem</i> the <i>units</i> in question.
friendly society	an <i>incorporated friendly society</i> or a <i>registered friendly society</i> .
FSA	the Financial Services Authority.
future	the <i>investment</i> , specified in article 84 of the <i>Regulated Activities Order</i> (Futures), which is, in summary: rights under a contract for the sale of a <i>commodity</i> or property of any other description under which delivery is to be made at a future date and at a price agreed on when the contract is made.
geared futures and options scheme	an <i>authorised fund dedicated to derivatives</i> (where most or all of the extent of the <i>investment</i> is limited by the amount of property available to put up as <i>initial outlay</i>), whether with or without <i>transferable securities</i> .
government and public security	the <i>investment</i> , specified in article 78 of the <i>Regulated Activities Order</i> (Government and public securities) which is in summary: a loan stock, bond or other instruments creating or acknowledging indebtedness, issued by or on behalf of any of the following: <ul style="list-style-type: none"> (a) the government of the <i>United Kingdom</i>; or (b) the Scottish Administration; or

- (c) the Executive Committee of the Northern Ireland Assembly; or
- (d) the National Assembly of Wales; or
- (e) the government of any country or territory outside the *United Kingdom*; or
- (f) a local authority in the *United Kingdom* or elsewhere; or
- (g) a body the members of which comprise:
 - (i) states including the *United Kingdom* or another *EEA State*; or
 - (ii) bodies whose members comprise states including the *United Kingdom* or another *EEA State*;

but excluding:

- (A) the instruments specified in article 77(2)(a) to (d) of the *Regulated Activities Order*;
- (B) any instrument creating or acknowledging indebtedness in respect of:
 - (I) money received by the Director of Savings as *deposits* or otherwise in connection with the business of the National Savings Bank; or
 - (II) money raised under the National Loans Act 1968 under the auspices of the *Director* of Savings or treated as so raised under section 11(3) of the National Debt Act 1972.

group

(as defined in section 421 of the *Act* (Group)) (in relation to a *person* ("A")) A and any *person* who is:

- (a) a *parent undertaking* of A;
- (b) a *subsidiary undertaking* of A;
- (c) a *subsidiary undertaking* of a *parent undertaking* of A;
- (d) a *parent undertaking* of a *subsidiary undertaking* of A;
- (e) an *undertaking* in which A or an *undertaking* in (a) to (d) has a participating interest;
- (f) if A or an *undertaking* in (a) or (d) is a *building society*, an associated undertaking of that *building society*;
- (g) if A or an *undertaking* in (a) or (d) is an *incorporated friendly Society*, a *body corporate* of which that *friendly society* has joint *control* (as defined in section 13(9)(c) or (cc) of the Friendly Societies Act 1992);

in this definition:

- (i) "participating interest" has the same meaning as in Part VII of the Companies Act 1985 or Part VIII of the Companies (Northern Ireland) Order 1986; but also includes an interest held by an individual which would be a participating interest for the purposes of those provisions if he were an *undertaking*;
- (ii) "associated undertaking" has the meaning given in section 119(1) of the Building Societies Act 1986.

(see also *immediate group*)

guidance

guidance given by the *FSA* under the *Act*.

habitual residence

- (a) if the *policyholder* is an individual, the address given by the *policyholder* as his residence if it reasonably appears to be a residential address and there is no evidence to the contrary;
- (b) if the *policyholder* is not an individual or a *group* of individuals, the State in which the *policyholder* has its place of establishment, or, if it has more than one, its relevant place of establishment;

	(c) in respect of the variation of a <i>life policy</i> , or the purchase of a <i>pension annuity</i> related to a <i>life policy</i> , unless there is evidence to the contrary, the habitual residence of the <i>policyholder</i> at the date on which the <i>policyholder</i> signed the proposal for the <i>life policy</i> .
higher volatility fund	a <i>regulated collective investment scheme</i> which is: <ul style="list-style-type: none"> (a) a <i>geared futures and options scheme</i>, a <i>geared securities scheme</i> or a <i>warrant scheme</i>; (b) a <i>fund of funds scheme</i> of which one or more of the <i>schemes</i> to which it is <i>dedicated</i> falls within (a); or (c) an <i>umbrella scheme</i>, a <i>sub-fund</i> of which, if it were a separate fund, would fall within (a).
holding company	(as defined in section 736(1) of the <i>Companies Act 1985</i> ("Subsidiary", "holding company" and "wholly-owned subsidiary")) (in relation to another <i>body corporate</i> ("S")) a <i>body corporate</i> which: <ul style="list-style-type: none"> (a) holds a majority of the voting rights in S; or (b) is a member of S and has the right to appoint or remove a majority of its board of directors; or (c) is a member of S and controls alone, under an agreement with other shareholders and members, a majority of the voting rights in S.
incoming EEA firm	(in accordance with section 193(1)(a) of the <i>Act</i>) an <i>EEA firm</i> which is exercising, or has exercised, its right to carry on a <i>regulated activity</i> in the <i>United Kingdom</i> in accordance with Schedule 3 to the <i>Act</i> (EEA Passport Rights).
incoming Treaty firm	(in accordance with section 193(1)(b) of the <i>Act</i> (interpretation of this Part)) a <i>Treaty firm</i> which is exercising, or has exercised, its right to carry on a <i>regulated activity</i> in the <i>United Kingdom</i> in accordance with Schedule 4 to the <i>Act</i> (Treaty rights).
incorporated friendly society	a society incorporated under the Friendly Societies Act 1992.
independent intermediary	a <i>firm</i> acting as an intermediary but excluding: <ul style="list-style-type: none"> (a) a <i>firm</i> which is a member of a <i>marketing group</i>; (b) a <i>product provider</i> which <i>sells</i> its own <i>packaged products</i>.
industrial assurance policy	a <i>policy</i> of industrial assurance, as defined in the Industrial Assurance Act 1923.
initial margin	the amount which under the rules of the relevant exchange or <i>clearing house</i> the <i>firm</i> or an <i>intermediate broker</i> would be required to deposit in cash as a fidelity deposit in respect of all the <i>client's</i> open positions in <i>margined transactions</i> at that time, irrespective of any unrealised profit or loss on such positions, on the assumption that those transactions were the only transactions undertaken under the rules of that exchange or that <i>clearing house</i> by the <i>firm</i> or the <i>intermediate broker</i> at that time.
insurance business	the business of <i>effecting</i> or <i>carrying out contracts of insurance</i> .
Insurance Directives	the <i>First Life Directive</i> , <i>Second Life Directive</i> and <i>Third Life Directive</i> and the <i>First Non-Life Directive</i> , <i>Second Non-Life Directive</i> and <i>Third Non-Life Directive</i> .
insurance undertaking	an undertaking, whether or not an <i>insurer</i> , which carries on <i>insurance business</i> .
insurer	a <i>firm</i> with <i>permission</i> to <i>effect</i> or <i>carry out contracts of insurance</i> (other than

	a <i>bank</i>).
intermediate broker	(in relation to a transaction in a <i>contingent liability investment</i>) any <i>person</i> acting in the capacity of an intermediary through whom the <i>firm</i> undertakes that transaction.
intermediate customer	<p>a <i>client</i> who is not a <i>market counterparty</i> and who is:</p> <ul style="list-style-type: none"> (a) a local authority or public authority; (b) a <i>body corporate</i> whose <i>shares</i> have been <i>listed</i> or <i>admitted to trading</i> on any <i>EEA</i> exchange; (c) a <i>body corporate</i> whose <i>shares</i> have been <i>listed</i> or <i>admitted to trading</i> on the primary board of any <i>IOSCO</i> member country official exchange; (d) a <i>body corporate</i> (including a <i>limited liability partnership</i>) which has (or any of whose <i>holding companies</i> or <i>subsidiaries</i> has) (or has had at any time during the previous two years) called up share capital or net assets of at least £5 million (or its equivalent in any other currency at the relevant time); (e) a <i>special purpose vehicle</i>; (f) a <i>partnership</i> or unincorporated association which has (or has had at any time during the previous two years) net assets of at least £5 million (or its equivalent in any other currency at the relevant time) and calculated in the case of a limited <i>partnership</i> without deducting loans owing to any of the <i>partners</i>; (g) a trustee of a trust (other than an <i>occupational pension scheme</i>, <i>SSAS</i> or <i>stakeholder pension scheme</i>) which has (or has had at any time during the previous two years) assets of at least £10 million (or its equivalent in any other currency at the relevant time) calculated by aggregating the value of the cash and <i>designated investments</i> forming part of the trust's assets, but before deducting its liabilities; (h) a trustee of an <i>occupational pension scheme</i>, <i>SSAS</i> or <i>stakeholder pension scheme</i> where the trust has (or has had at any time during the previous two years): <ul style="list-style-type: none"> (i) at least 50 members; and (ii) assets under management of at least £10 million (or its equivalent in any other currency at the relevant time); (i) another <i>firm</i>, or an <i>overseas financial services institution</i>, when, in relation to <i>designated investment business</i>, or related <i>ancillary activities</i>, conducted with or for that <i>firm</i> or institution, that <i>firm</i> or institution is an <i>intermediate customer</i> in accordance with <i>COB 4.1.7R</i> (Classification of another firm or an overseas financial services institution); (j) an <i>unregulated collective investment scheme</i>; (k) a <i>client</i> when he is classified as an <i>intermediate customer</i> in accordance with <i>COB 4.1.9R</i> (Expert private customer classified as intermediate customer); <p>but excluding:</p> <ul style="list-style-type: none"> (A) a <i>regulated collective investment scheme</i>; and (B) a <i>client</i> who would otherwise be an <i>intermediate customer</i>, when he is classified in accordance with: <ul style="list-style-type: none"> (I) <i>COB 4.1.12R</i> (Large intermediate customer classified as market counterparty); or (II) (except for the purposes of <i>DISP</i>) <i>COB 4.1.14R</i> (Client classified as

	private customer).
introducer	<p>an individual appointed by a <i>provider firm</i> or by an <i>appointed representative</i> of such a <i>firm</i>, to carry out in the course of <i>designated investment business</i> either or both of the following activities:</p> <p>(a) effecting introductions;</p> <p>(b) distributing <i>non-real time financial promotions</i>.</p>
investment	(in accordance with sections 22(4) and 397(13) (Miscellaneous offences) of the <i>Act</i>) any investment, including any asset, right or interest.
investment company with variable capital	a body incorporated under the <i>OEIC Regulations</i> .
investment firm	any legal person the regular occupation or business of which is the provision of <i>core investment services</i> for third parties on a professional basis, as defined in article 1(2) of the <i>ISD</i> , and in relation to a person with his head office in an <i>EEA State</i> a <i>person</i> , who is not a legal person, included as an <i>investment firm</i> by his or its <i>Home State</i> . (See also <i>ISD investment firm</i> .)
investment management firm	<p>a <i>firm</i> whose <i>permitted activities</i> include <i>designated investment business</i>, which is not a <i>bank</i>, <i>building society</i>, <i>credit union</i>, <i>friendly society</i>, <i>ICVC</i>, <i>insurer</i>, <i>media firm</i>, <i>authorised professional firm</i>, <i>service company</i>, <i>incoming EEA firm</i> (without a <i>top-up permission</i>), <i>incoming Treaty firm</i> (without a <i>top-up permission</i>) or <i>UCITS qualifier</i> (without a <i>top up permission</i>), whose <i>permission</i> does not include a <i>requirement</i> that it comply with <i>IPRU(INV) 3</i> or <i>10</i> (Securities and futures firms) or <i>13</i> (Personal investment firms) and which is within (a), (b) or (c):</p> <p>(a) a <i>firm</i>:</p> <p>(i) which was a member of <i>IMRO</i> immediately before <i>commencement</i>; and</p> <p>(ii) which was not, immediately before <i>commencement</i>, subject to the financial supervision requirements of the <i>FSA</i> (under section 43 of the Financial Services Act 1986), <i>PIA</i> or <i>SFA</i> under lead regulation arrangements;</p> <p>(b) a <i>firm</i> whose <i>permission</i> includes a <i>requirement</i> that it comply with <i>IPRU(INV) 5</i> (Investment management firms);</p> <p>(c) a <i>firm</i>:</p> <p>(i) which was given a <i>Part IV permission</i> on or after <i>commencement</i>, or which was authorised under section 25 of the Financial Services Act 1986 immediately before <i>commencement</i> and was not a member of <i>IMRO</i>, <i>PIA</i> or the <i>SFA</i>; and</p> <p>(ii) for whom the most substantial part of its gross income, including <i>commissions</i>, from the <i>regulated activities</i> included in its <i>Part IV permission</i> is derived from one or more of the following activities (based, for a <i>firm</i> given a <i>Part IV permission</i> after <i>commencement</i>, on the business plan submitted as part of the <i>firm's</i> application or, for a <i>firm</i> authorised under section 25 of the Financial Services Act 1986, on the <i>firm's financial year</i> preceding its <i>authorisation</i> under the <i>Act</i>):</p> <p>(A) <i>managing investments</i> other than for <i>private customers</i> or where the assets managed are primarily <i>derivatives</i>;</p> <p>(B) <i>OPS activity</i>;</p> <p>(C) acting as the <i>manager</i> or <i>trustee</i> of an <i>AUT</i>;</p>

	(D) acting as the <i>ACD</i> or <i>depository</i> of an <i>ICVC</i> ;
	(E) <i>establishing, operating or winding up a collective investment scheme</i> (other than an <i>AUT</i> or <i>ICVC</i>);
	(Ea) <i>establishing, operating or winding up a personal pension scheme</i> ; and
	(F) <i>safeguarding and administering investments</i> .
investment manager	a <i>person</i> who, acting only on behalf of a <i>client</i> : (a) manages <i>designated investments</i> in an account or portfolio on a discretionary basis under the terms of a discretionary management agreement; or (b) manages <i>designated investments</i> in an account or portfolio on a non-discretionary basis under the terms of a <i>non-discretionary management agreement</i> .
investment service	a <i>core investment service</i> or <i>non-core investment service</i> .
Investment Services Directive	the Council Directive of 10 May 1993 on investment services in the securities field (No 93/22/EEC).
investment trust	a <i>company listed</i> in the <i>United Kingdom</i> or another <i>EEA State</i> which: (a) is approved by the Commissioners for HM Revenue and Customs under section 842 of the Income and Corporation Taxes Act 1988 (or, in the case of a newly formed <i>company</i> , has declared its intention to conduct its affairs so as to obtain such approval); or (b) is resident in an <i>EEA State</i> other than the <i>United Kingdom</i> and would qualify for such approval if resident and <i>listed</i> in the <i>United Kingdom</i> .
investment trust savings scheme	(a) a <i>dealing</i> service (whether or not held within a <i>pension contract</i>) dedicated to the <i>securities</i> of a particular <i>investment trust</i> , or of <i>investment trusts</i> within a particular <i>marketing group</i> ; (b) <i>securities</i> to be acquired through an investment trust savings scheme in (a).
IPRU(INV)	the Interim Prudential sourcebook for investment businesses.
ISD investment firm	an <i>investment firm</i> that has its registered office (or, if it has no registered office, its head office) in an <i>EEA State</i> : (a) excluding a <i>person</i> to whom the <i>ISD</i> does not apply under article 2(2) of the <i>ISD</i> ; but (b) including a <i>BCD credit institution</i> whose <i>Home State authorisation</i> includes a <i>core investment service</i> .
large exposure	any <i>exposure</i> to another <i>person</i> , or to two or more <i>affiliated persons</i> , which equals or exceeds 10 per cent. of the <i>firm's</i> own funds;
lead regulated firm	a <i>firm</i> which is the subject of the financial supervision requirements of an <i>overseas regulator</i> in accordance with an agreement between the <i>FSA</i> and that regulator relating to the financial supervision of <i>firms</i> whose head office is within the country of that regulator.
life policy	(in accordance with the definition of "qualifying contract of insurance" in article 3(1) of the <i>Regulated Activities Order</i>) a <i>long-term insurance contract</i> (which includes a <i>pension policy</i>) other than a reinsurance contract and a <i>pure protection contract</i> .
linked benefit	a benefit payable under a <i>life policy</i> or a <i>regulated collective investment scheme</i> the amount of which is determined by reference to: (a) the value of the property of any description (whether specified or not); or

	<ul style="list-style-type: none"> (b) fluctuations in the value of any such property; or (c) income from such property; or (d) fluctuations in an index of the value of such property.
long-term insurance contract	<p>(in accordance with article 3(1) of the <i>Regulated Activities Order</i> (Interpretation: general)) any <i>contract of insurance</i> within Part II of Schedule 1 to the <i>Regulated Activities Order</i> (Contracts of long-term insurance), namely:</p> <ul style="list-style-type: none"> (a) <i>life and annuity</i> (paragraph I); (b) <i>marriage</i> or the formation of a civil partnership <i>and birth</i> (paragraph II); (c) <i>linked long-term</i> (paragraph III); (d) <i>permanent health</i> (paragraph IV); (e) <i>tontines</i> (paragraph V); (f) <i>capital redemption</i> (paragraph VI); (g) <i>pension fund management</i> (paragraph VII); (h) <i>collective insurance</i> etc (paragraph VIII); (i) <i>social insurance</i> (paragraph IX).
long-term insurer	an <i>insurer</i> with permission to effect or carry out <i>long-term insurance contracts</i> .
low resource firm	<p>a <i>Category B3 firm</i> which is not a <i>network</i>, has fewer than 26 <i>financial advisers</i> or <i>representatives</i> and is not <i>permitted</i> to:</p> <ul style="list-style-type: none"> (a) carry on discretionary portfolio management; (b) <i>establish, operate or wind up a personal pension scheme</i>; or (c) delegate the activities in (a) or (b) to an <i>investment firm</i>.
making arrangements with a view to transactions in investments	<p>the <i>regulated activity</i>, specified in article 25(2) of the <i>Regulated Activities Order</i> (Arranging deals in investments), which is, in summary: making arrangements with a view to a <i>person</i> who participates in the arrangements <i>buying, selling</i>, subscribing for or underwriting any of the following <i>investments</i> (whether as <i>principal</i> or agent):</p> <ul style="list-style-type: none"> (a) a <i>designated investment</i>; (b) the <i>underwriting capacity of a Lloyd's syndicate</i>; (c) <i>membership of a Lloyd's syndicate</i>; (d) <i>rights to or interests in investments</i> in (b) or (c).
managing investments	<p>the <i>regulated activity</i>, specified in article 37 of the <i>Regulated Activities Order</i> (Managing investments), which is, in summary: managing assets belonging to another <i>person</i> in circumstances which involve the exercise of discretion if:</p> <ul style="list-style-type: none"> (a) the assets consist of or include any <i>designated investment</i>; or (b) the arrangements for their management are such that the assets may consist of or include such <i>investments</i>, and either the assets have at any time since 29 April 1988 done so, or the arrangements have at any time (whether before or after that date) been held out as arrangements under which the assets would do so.
market maker	(in relation to an <i>investment</i>), a <i>person</i> who (otherwise than in his capacity as the <i>operator</i> of a <i>regulated collective investment scheme</i>) holds himself out

	as able and willing to enter into transactions of sale and purchase in <i>investments</i> of that description at prices determined by him generally and continuously rather than in respect of each particular transaction.
market value	the market value as determined in accordance with generally accepted accounting practice.
marketable debt instrument	a <i>debt instrument</i> which is a <i>marketable investment</i> ;
marketable investment	<ul style="list-style-type: none"> (a) an <i>investment</i> which is traded on or under the rules of an exchange; (b) a debt instrument which may be transferred without the consent of the <i>issuer</i> or any other <i>person</i> (including a collateralised mortgage obligation); (c) a <i>commodity</i>; (d) a <i>warrant, option, future</i> or other instrument which entitles the holder to subscribe for or acquire: <ul style="list-style-type: none"> (i) an <i>investment</i> or <i>commodity</i> in (a) to (c); or (ii) any currency; or (iii) any combination of (i) and (ii); (e) a <i>contract for differences</i> (including interest rate and currency swaps) relating to fluctuations in: <ul style="list-style-type: none"> (i) the value or price of an <i>investment</i> or <i>commodity</i> in (a) to (d); or (ii) any currency; or (iii) the rate of interest in any currency or any index of such rates; or (iv) the level of any index which is derived from the prices of an <i>investment</i> or <i>commodity</i> in (a) to (c); or (v) any combination of (i) to (iv); (f) <i>warrants, options, futures</i> or other instruments entitling the holder to obtain the rights of those contracts in (d) or (e); (g) a <i>unit</i> in a <i>regulated collective investment scheme</i>.
marketing group	<p>a group of <i>persons</i> who:</p> <ul style="list-style-type: none"> (a) are allied together (either formally or informally) for purposes of marketing <i>packaged products</i> of the marketing group; and (b) each of whom, if it holds itself out in the <i>United Kingdom</i> as marketing <i>packaged products to private customers</i>, does so only as an <i>investment manager</i> or in relation to <i>packaged products</i> of the marketing group.
marketing group associate	a <i>firm</i> other than a <i>product provider</i> which is a member of a <i>marketing group</i> .
material current year losses	losses of an amount equal to 10 per cent or more of the amount by which the own funds of an <i>undertaking</i> exceed the own funds needed to meet financial resources test 1 as prescribed in chapter 13;
material holding	<p>means a holding of -</p> <ul style="list-style-type: none"> (a) ordinary share capital and non cumulative preference share capital; or (b) subordinated loan and non fixed-term cumulative preference share capital, in a <i>credit institution</i> or a <i>financial institution</i> where - <ul style="list-style-type: none"> (i) (a) or (b) above exceeds 10% of the share capital plus share premium of the issuer; or (ii) the aggregate of (a) and (b) above exceeds 10% of the <i>firm's own funds</i>,

	before deducting the holding.
money-market instrument	<p>any of the following <i>investments</i>:</p> <p>(a) a <i>debenture</i> which is issued on terms requiring repayment not later than five years from the date of issue;</p> <p>(b) any <i>government and public security</i> which is issued on terms requiring repayment not later than one year or, if issued by a local authority in the <i>United Kingdom</i>, five years from the date of <i>issue</i>;</p> <p>(c) a <i>warrant</i> which entitles the holder to subscribe for an <i>investment</i> within (a) or (b);</p> <p>(d) a <i>certificate representing certain securities or rights to or interests in investments</i> relating, in either case, to an <i>investment</i> within (a) or (b);</p> <p>(e) an <i>option</i> relating to:</p> <p>(i) an instrument in (a) or (b); or</p> <p>(ii) currency of the <i>United Kingdom</i> or of any other country or territory; or</p> <p>(iii) gold or silver;</p> <p>(f) a <i>future</i> for the sale of:</p> <p>(i) an instrument in (a) or (b); or</p> <p>(ii) currency of the <i>United Kingdom</i> or of any other country or territory; or</p> <p>(iii) gold or silver;</p> <p>(g) a <i>contract for differences</i> by reference to fluctuations in:</p> <p>(i) the value or price of any instrument within any of (a) to (f); or</p> <p>(ii) currency of the <i>United Kingdom</i> or of any other country or territory; or</p> <p>(iii) the rate of interest on loans in any such currency or any index of such rates;</p> <p>(h) an <i>option</i> to acquire or dispose of an instrument within (e),(f) or (g).</p>
money-purchase benefits	(in relation to an <i>occupational pension scheme</i>) benefits the rate or amount of which are calculated by reference to a payment or payments made by a member of the scheme.
net current assets	the total, at a particular date, of all assets which are not intended for use on a continuing basis in the <i>firm's</i> business (i.e. current assets), less all the liabilities payable within 12 months of that date
net long position	the situation in which a <i>firm</i> holds or will hold more <i>units in a investment</i> than it has contracted to <i>sell</i> or, in respect of <i>options</i> , where it has bought rights which exceed rights sold;
net open foreign currency position	a <i>firm's net long position</i> or <i>net short position</i> , whichever is the higher, in a currency other than that in which the <i>firm's</i> books of account are maintained, calculated in accordance with the appropriate <i>rules</i> in chapter 13;
net short position	the situation in which a <i>firm</i> has contracted to <i>sell</i> more of an <i>investment</i> than it holds or will hold or, in respect of <i>options</i> , where it has sold rights which exceed the rights bought;
nominee company	a <i>body corporate</i> whose business consists solely of acting as a nominee holder of <i>investments</i> or other property.

occupational pension scheme	(as specified in article 3(1) of the <i>Regulated Activities Order</i> (Interpretation: general)) any scheme or arrangement which is comprised in one or more instruments or agreements and which has, or is capable of having, effect in relation to one or more descriptions or categories of employment so as to provide benefits, in the form of pensions or otherwise, payable on termination of service, or on death or retirement, to or in respect of earners with a qualifying service in an employment of any such description or category.
OEIC	<i>open-ended investment company</i> . (see also <i>ICVC</i>).
offer price	the price at which a <i>person</i> could purchase or <i>unit</i> in a dual priced <i>AUT</i> or a <i>security</i> .
Ombudsman	a <i>person</i> appointed to the panel of <i>persons</i> maintained by the <i>FOS Ltd</i> to determine complaints, including the Chief Ombudsman.
on-exchange	(a) (in relation to a transaction in the <i>United Kingdom</i>) effected by means of the <i>facilities</i> of, or governed by the <i>rules</i> of, an <i>RIE</i> or a <i>regulated market</i> . (b) (in relation to any other transaction) effected by means of the <i>facilities</i> of, or governed by the <i>rules</i> of, an exchange.
open-ended investment company	(as defined in section 236 of the <i>Act</i> (Open-ended investment companies)), a <i>collective investment scheme</i> which satisfies both the property condition and the investment condition: (a) the property condition is that the property belongs beneficially to, and is managed by or on behalf of, a body corporate ("BC") having as its purpose the investment of its funds with the aim of: <ul style="list-style-type: none"> (i) spreading investment risk; and (ii) giving its members the benefit of the results of the management of those funds by or on behalf of that body; (b) the investment condition is that, in relation to BC, a reasonable investor would, if he were to participate in the <i>scheme</i> : <ul style="list-style-type: none"> (i) expect that he would be able to realise, within a period appearing to him to be reasonable, his investment in the <i>scheme</i> (represented, at any given time, by the value of shares in, or securities of, BC held by him as a <i>participant</i> in the <i>scheme</i>); and (ii) be satisfied that his investment would be realised on a basis calculated wholly or mainly by reference to the value of property in respect of which the <i>scheme</i> makes arrangements. (see also <i>investment company with variable capital</i>)
open-market option	the option to apply: (a) the proceeds of a <i>pension policy</i> or <i>pension contract</i> ; or (b) the proceeds of a <i>money-purchase occupational scheme</i> for a particular occupational scheme member; to purchase an annuity on the open market from a <i>life office</i> .
option	the <i>investment</i> specified in article 77 of the <i>Regulated Activities Order</i> (Options), which is an option to acquire or dispose of:

	(a) a <i>designated investment</i> (other than an option);
	(b) currency of the <i>United Kingdom</i> or of any other country or territory;
	(c) palladium, platinum, gold or silver; or
	(d) an option to acquire or dispose of an option specified in (a), (b) or (c).
OTC	<i>over the counter</i> .
over the counter	(in relation to a transaction in an <i>investment</i>) not <i>on-exchange</i> .
overseas firm	a <i>firm</i> which has its <i>registered</i> office (or, if it has no <i>registered</i> office, its head office) outside the <i>United Kingdom</i> .
overseas introducing broker	a <i>person</i> , who is not an <i>authorised person</i> : (a) who is resident outside the <i>United Kingdom</i> ; and (b) who introduces transactions relating to <i>designated investments arranged (brought about)</i> for its <i>clients</i> to a <i>clearing firm</i> in the <i>United Kingdom</i> .
overseas person	(in accordance with article 3(1) of the <i>Regulated Activities Order</i> (Interpretation: general)) a <i>person</i> who: (a) carries on any of the following <i>regulated activities</i> : (i) <i>dealing in investments as principal</i> ; (ii) <i>dealing in investments as agent</i> ; (iii) <i>arranging (bringing about) deals in investments</i> ; (iv) <i>making arrangements with a view to transactions in investments</i> ; (v) <i>managing investments</i> ; (vi) <i>safe custody and administering investments</i> ; (vii) <i>sending dematerialised instructions</i> ; (viii) <i>causing dematerialised instructions to be sent</i> ; (ix) <i>establishing, operating or winding up a collective investment scheme</i> ; (x) <i>acting as trustee of an authorised unit trust scheme</i> ; (xi) <i>acting as the depositary or sole director of an open-ended investment company</i> ; (xii) <i>establishing, operating or winding up a stakeholder pension scheme</i> ; (xiii) <i>advising on investments</i> ; (xiv) <i>agreeing to carry on those regulated activities</i> , disregarding the exclusion in article 72 of the <i>Regulated Activities Order</i> (Overseas persons); but (b) does not carry on any such activities, or offer to do so, from a permanent place of business maintained by him in the <i>United Kingdom</i> .
overseas regulator	(as defined in section 195(3) of the <i>Act</i> (Exercise of power in support of overseas regulator)) an authority in a country or territory outside the <i>United Kingdom</i> : (a) which is a <i>Home State regulator</i> ; or (b) which exercises any of the following functions: (i) a function corresponding to any function of the <i>FSA</i> under the <i>Act</i> ; (ii) a function corresponding to any function exercised by the <i>FSA</i> in its

	capacity as <i>competent authority</i> in relation to the listing of securities;
	(iii) a function corresponding to any function exercised by the Secretary of State under the Companies Act 1985;
	(iv) a function in connection with the investigation of conduct of the kind prohibited by Part V of the Criminal Justice Act 1993 (Insider Dealing), or with the enforcement of rules (whether or not having the force of law) relating to such conduct;
	(v) a function prescribed by regulations made for the purposes of section 195(4) of the Act (Exercise of powers) which, in the opinion of the Treasury, relates to companies or financial services.
own account order	an order which relates to an <i>own account transaction</i> .
own account transaction	a transaction <i>executed</i> by the <i>firm</i> for its own benefit or for the benefit of its <i>associate</i> .
packaged product	(a) a <i>life policy</i> ; (b) a <i>unit</i> in a <i>regulated collective investment scheme</i> ; (c) an interest in an <i>investment trust savings scheme</i> ; (d) a <i>stakeholder pension scheme</i> ; whether or not (in the case of (a), (b) or (c)) held within a <i>PEP</i> or an <i>ISA</i> .
parent undertaking	(in accordance with section 420 of the <i>Act</i> (Parent and subsidiary undertaking) and section 258 of the Companies Act 1985 (Parent and subsidiary undertakings)): (1) (in relation to whether an <i>undertaking</i> (other than an <i>incorporated friendly society</i> is a parent undertaking) an <i>undertaking</i> which has the following relationship to another <i>undertaking</i> ("S")): (a) it holds a majority of the voting rights in S; or (b) it is a member of S and has the right to appoint or remove a majority of its board of directors; or (c) it has the right to exercise a dominant influence over S through: (i) provisions contained in S's memorandum or articles; or (ii) a control contract; (d) it is a member of S and controls alone, under an agreement with other shareholders or members, a majority of the voting rights in S; or (e) (i) it has the power to exercise, or actually exercises dominant influence or control over S; or (ii) it and S are managed on a unified basis; or (f) it is a <i>parent undertaking</i> of a <i>parent undertaking</i> of S; (g) (except in <i>REC</i> and <i>LLD</i>) it is an individual and would be a <i>parent undertaking</i> if it were an <i>undertaking</i> ; or (h) (except in <i>REC</i> and <i>LLD</i>) it is incorporated in or formed under the law of another <i>EEA State</i> and is a parent undertaking within the meaning of any rule of law in that State for purposes connected with implementation of the <i>Seventh Company Law Directive</i> ; in relation to (b) and (d), the <i>undertaking</i> will be treated as a member of S if any of its <i>subsidiary undertakings</i> is a member of S, or if any shares in S are held by a person acting on behalf of the <i>undertaking</i> or any of its <i>subsidiary undertakings</i> ; the provisions of Schedule 10A to the Companies Act 1985 (Parent and

subsidiary undertakings: supplementary provisions) explain the expressions used in and supplement paragraphs (a) to (f);

(2) (in relation to whether an *incorporated friendly society is a parent undertaking*) an *incorporated friendly society* which has the following relationship to a *body corporate* ("S"):

- (a) it holds a majority of the voting rights in S; or
- (b) it is a *member* of S and has the right to appoint or remove a majority of S's board of directors; or
- (c) it is a member of S and controls alone, under an agreement with other shareholders or members, a majority of the voting rights in S.

(d) it is the parent undertaking of a body corporate which has the relationship in (a), (b) or (c) to S.

penny share a *readily realisable security* in relation to which the bid-offer spread is 10 per cent or more of the offer price, but not:

- (a) a *government and public security*; or
- (b) a *share* in a *company* quoted on The Financial Times Stock Exchange 100 Index; or
- (c) a *security* issued by a *company* which, at the time that the *firm deals* or recommends to the *client* to *deal* in the *investment*, has a market capitalisation of £100 million or more (or its equivalent in any other currency at the relevant time).

pension annuity an *investment* purchased with the sums derived from the vesting (partial or full) of a *pension policy* or *pension contract*, for the purposes of securing the beneficiary's entitlement to immediate or *future benefits*.

pension buy-out contract an annuity contract which complies with paragraph (g) of section 591(2) of the Income and Corporation Taxes Act 1988.

pension contract a contract under which rights to benefits are obtained by the making of contributions to an *occupational pension scheme* or to a *personal pension scheme*, where the contributions are paid to a *regulated collective investment scheme*.

pension opt-out a transaction resulting from a decision made, with or without advice from a *firm*, by a *customer* who is an individual, to:

- (a) opt out of an *occupational pension scheme* of which he is a current member; or
- (b) decline to become a member of an *occupational pension scheme* which he is eligible to join or which he will become eligible to join at the end of a waiting period;

in favour of a *stakeholder pension scheme* or a *personal pension scheme* (including a self-invested *personal pension scheme*).

pension policy a contract under which a right to benefits results from contributions made to an *occupational pension scheme* or to a *personal pension scheme*, where the contributions are paid to a *long-term insurer*.

pension scheme a scheme under which a right to benefits results from contributions made under a *pension contract* or *pension policy*.

pension transfer a transaction resulting from a decision made, with or without advice from a *firm*, by a *customer* who is an individual, to transfer deferred benefits from:

- (a) an *occupational pension scheme*; or
- (b) an *individual pension contract* providing fixed or guaranteed benefits

that replaced similar benefits under a *defined benefits pension scheme*; to a *stakeholder pension scheme* or a *personal pension scheme* (including a self-invested *personal pension scheme*).

PEP	a <i>personal equity plan</i> .
PEP manager	the <i>plan manager</i> of a <i>PEP</i> .
PEP transfer	a transaction resulting from a decision, made with or without advice from a <i>firm</i> , by a <i>customer</i> who is an individual, to transfer the <i>investments</i> (or their value) held in his existing <i>PEP</i> in favour of another <i>PEP</i> which may or may not be managed by the same <i>PEP manager</i> .
permitted activity	a <i>regulated activity</i> which a <i>firm</i> has <i>permission</i> to carry on.
permitted third party	a third party who is: <ul style="list-style-type: none">(a) an <i>authorised person</i>; or(b) an <i>exempt person</i> for whom an <i>authorised person</i> is accepting responsibility; or(c) a <i>person</i> lawfully carrying on a <i>regulated activity</i> in another <i>EEA State</i>.
person	(in accordance with the Interpretation Act 1978) any person, including a body of persons corporate or unincorporate (that is, a natural person, a legal person, and, for example, a <i>partnership</i>).
personal equity plan	a scheme of investment satisfying the conditions prescribed in regulations made by the Treasury under section 333 of the Income and Corporation Taxes Act 1988 (the Personal Equity Plan Regulations 1989).
personal investment firm	a <i>firm</i> whose <i>permitted activities</i> include <i>designated investment business</i> , which is not an <i>authorised professional firm</i> , <i>bank</i> , <i>building society</i> , <i>credit union</i> , <i>friendly society</i> , <i>ICVC</i> , <i>insurer</i> , <i>media firm</i> , <i>service company</i> , <i>incoming EEA firm</i> (without a <i>top-up permission</i>), <i>incoming Treaty firm</i> (without a <i>top-up permission</i>) or <i>UCITS qualifier</i> , whose <i>permission</i> does not include a <i>requirement</i> that it comply with <i>IPRU(INV) 3</i> (Securities and futures firms), 5 (Investment management firms) or 10 (Securities and futures firms), and which is within (a), (b) or (c): <ul style="list-style-type: none">(a) a <i>firm</i>:<ul style="list-style-type: none">(i) which was a member of <i>PIA</i> immediately before <i>commencement</i>; and(ii) which was not, immediately <i>before commencement</i>, <i>subject to the financial supervision</i> requirements of the <i>FSA</i> (under section 43 of the Financial Services Act 1986), <i>IMRO</i> or <i>SFA</i> under lead regulation arrangements;(b) a <i>firm</i> whose <i>permission</i> includes a <i>requirement</i> that it comply with <i>IPRU(INV) 13</i> (Personal investment firms);(c) a <i>firm</i>:<ul style="list-style-type: none">(i) which was given a <i>Part IV permission</i> after <i>commencement</i>, or which was authorised under section 25 of the Financial Services Act 1986 immediately before <i>commencement</i> and not a member of <i>IMRO</i>, <i>PIA</i> or <i>SFA</i>; and(ii) for whom the most substantial part of its gross income, including <i>commissions</i>, from the <i>regulated activities</i> included in its <i>Part IV permission</i> is derived from one or more of the following activities (based, for a <i>firm</i> given a <i>Part IV permission</i> after <i>commencement</i>, on the business plan submitted as part of the <i>firm's</i> application or, for a <i>firm</i> authorised under section 25 of the Financial Services Act 1986, on the <i>firm's financial year</i> preceding its <i>authorisation</i> under

	the Act):
	(A) <i>advising on investments, or arranging (bringing about) deals in investments</i> , in relation to <i>packaged products</i> ; and
	(B) <i>managing investments</i> for <i>private customers</i> .
personal pension contract	a <i>pension contract</i> under which contributions (single or regular) are paid to a <i>personal pension scheme</i> .
personal pension policy	a <i>pension policy</i> under which contributions (single or regular) are paid to a <i>personal pension scheme</i> .
personal pension scheme	a scheme of investment in accordance with section 630 of the Income and Corporation Taxes Act 1988.
PIA	the Personal Investment Authority Limited.
plan manager	in relation to: <ul style="list-style-type: none"> (a) a <i>group personal equity plan</i>, the plan manager of that plan in accordance with the Personal Equity Plan Regulations 1989; (b) a <i>group ISA</i>, the <i>ISA manager</i>; (c) a <i>group savings plan</i>, the <i>person</i> primarily responsible for that <i>group savings plan</i>.
premium	(1) (in relation to a <i>general insurance contract</i>) the consideration payable under the contract by the <i>policyholder</i> to the <i>insurer</i> . <p>(2) (in relation to a <i>long-term insurance contract</i>) a payment under the contract (except in SUP 16.8 (Persistency reports from insurers)); a premium is a regular premium if it is one of a series of payments under the contract:</p> <ul style="list-style-type: none"> (a) (i) which are payable on dates that are certain or ascertainable at the time the contract is made; (ii) which are payable over a period that exceeds one year in length; and (iii) assuming the <i>policy</i> evidencing the contract is not surrendered or otherwise terminated before the <i>premiums</i> fall due, will fall due on those dates without either party to the contract exercising any <i>option</i> under the contract; or <p>(b) of which the first payment is an obligation under the contract, and subsequent payments, calculated according to an agreed formula, are payable over a period which exceeds one year in length under a collateral written arrangement with the <i>insurer</i> or <i>friendly society</i>.</p> <p>(3) (in relation to an <i>option</i>) the total amount which the purchaser of the <i>option</i> is, or may be, required to pay in consideration for the right to exercise the <i>option</i>.</p>
previous regulator	(1) (in relation to a <i>firm</i> which was authorised under the Banking Act 1987 immediately before <i>commencement</i> or which was a European institution (as defined in the Banking Coordination (Second Council Directive) Regulations 1992) immediately before <i>commencement</i>) the FSA. <p>(2) (in relation to a <i>firm</i> which was a <i>building society</i> immediately before <i>commencement</i>) the Building Societies Commission.</p> <p>(3) (in relation to a <i>firm</i> which was a <i>friendly society</i> immediately before <i>commencement</i>) the Friendly Societies Commission.</p> <p>(4) (in relation to a <i>firm</i> authorised under the Insurance Companies Act 1982 immediately before <i>commencement</i>) the Treasury.</p>

- (5) (in relation to an *underwriting agent* which obtained the *permission* relevant to that category under the Financial Services and Markets Act 2000 (Repeals, Transitional Provisions and Savings) Order 2001 (SI 2001/xxx)) the *Society of Lloyd's*.
- (6) (in relation to a *firm* which was authorised, or which was an *appointed representative*, under the Financial Services Act 1986 immediately before *commencement* or which was a European investment firm (as defined in the Investment Services Regulations 1995 (SI 1995/3275)) immediately before *commencement*) any of:
 - (a) *IMRO*;
 - (b) *PIA*;
 - (c) *SFA*;
 - (d) a *recognised professional body*; and
 - (e) the *FSA*.

if the *firm* (or, if relevant, its principal for the purposes of section 44 of the Financial Services Act 1986) was subject in carrying on business to the rules, requirements, regulations or guidance of that body;

- (7) (in relation to an *ex-section 43 firm*) the *FSA*.

principal

- (1) in relation to a *person*:
 - (a) a *person* acting on his own account;
 - (b) (if the *person* is an *appointed representative*) the *authorised person* who is party to a contract with the *appointed representative* resulting in him being exempt under section 39 of the *Act* (Exemption of appointed representatives).
- (2) in relation to an *option, future* or forward contract:
 - (a) (except in the case of an *option* on a *future*) the amount of property or the value of the property which must be delivered in order to satisfy settlement of the *option, future* or forward contract;
 - (b) (in relation to an *option* on a *future*) the amount of property or the value of the property which must be delivered in order to satisfy settlement of the *future*.

private customer

a *client* who is not a *market counterparty* or an *intermediate customer*, including:

- (a) an individual who is not a *firm*;
- (b) an overseas individual who is not an *overseas financial services institution*;
- (c) a *regulated collective investment scheme*;
- (d) (except for the purposes of *DISP*) a *client* when he is classified as a *private customer* in accordance with COB 4.1.14R (Client classified as a private customer);

but excluding a *client*, who would otherwise be a *private customer*, when he is classified as an *intermediate customer* in accordance with COB 4.1.9R (Expert private customer classified as an intermediate customer).

product provider

a *firm* which is:

- (a) a *long-term insurer*;
- (b) a *friendly Society*;
- (c) the *operator* of a *regulated collective investment scheme* or an

	<i>investment trust savings scheme.</i>
professional fees	<i>Fees, commissions</i> and other receipts receivable in respect of legal, accountancy or actuarial <i>services</i> provide to <i>clients</i> but, excluding any items receivable in respect of <i>regulated activities</i> .
professional firm	a <i>person</i> which is: <ul style="list-style-type: none"> (a) an individual who is entitled to practice a profession regulated by a <i>designated professional body</i> and in practising it is subject to its rules; or (b) a <i>person</i> (not being an individual) which is managed and controlled by one or more individuals each of whom: <ul style="list-style-type: none"> (i) is entitled to practice a profession regulated by a <i>designated professional body</i>; and (ii) in practising it is subject to the rules of the <i>designated professional body</i>.
properly secured	fully secured by a first <i>charge</i> in favour of the <i>firm</i> on land and buildings, or on a <i>readily realisable investment</i> where the <i>firm</i> has in its possession or under its <i>control</i> a document of title or a document evidencing title to that <i>investment</i> ;
property enterprise trust	an <i>unregulated collective investment scheme</i> of which the underlying assets are land and buildings.
property fund	<ul style="list-style-type: none"> (a) a <i>regulated collective investment scheme</i> dedicated to land and interests in land; (b) a fund of funds of which one or more of the funds to which it is dedicated falls within (a); (c) a constituent part of an umbrella fund which, if it were a separate fund, would fall within (a);
provider firm	a <i>firm</i> ; that is: <ul style="list-style-type: none"> (a) a <i>product provider</i>; or (b) a <i>marketing group associate</i>.
pure protection contract	a <i>long-term insurance contract</i> in respect of which the following conditions are met: <ul style="list-style-type: none"> (a) the benefits under the contract are payable only on death or in respect of incapacity due to injury, sickness or infirmity; (b) the contract provides that benefits are payable on death (other than death due to an accident) only where the death occurs within ten years of the date on which the life of the person in question was first insured under the contract, or where the death occurs before that person attains a specified age not exceeding seventy years; (c) the contract has no <i>surrender value</i>, or the consideration consists of a single <i>premium</i> and the <i>surrender value</i> does not exceed that <i>premium</i>; (d) the contract makes no provision for its conversion or extension in a manner which would result in it ceasing to comply with any of (a), (b) or (c); and (e) the contract is not a reinsurance contract.
qualifying debt security	a debt <i>security</i> <ul style="list-style-type: none"> (a) issued or explicitly guaranteed by <ul style="list-style-type: none"> (i) a Zone A central government or central <i>bank</i>; (ii) a Zone B central government or central <i>bank</i>, provided that the

	<p><i>security</i> is denominated in its national currency;</p> <p>(iii) a local authority or regional government of the <i>United Kingdom</i> or another <i>Zone A country</i>;</p> <p>(iv) one of the following:</p> <p style="padding-left: 40px;"><i>a multilateral development bank</i>;</p> <p style="padding-left: 40px;">The Council of Europe;</p> <p>(b) issued by an <i>investment firm</i> or a comparable <i>undertaking regulated by a recognised third country</i> which is listed on a <i>regulated market</i> or a <i>recognised investment exchange</i>;</p>
qualifying investment	an <i>investment</i> which has been prescribed by the Treasury in the <i>Prescribed markets and Qualifying investments Order</i> (see <i>MAR 1</i> (Code of market conduct)).
recognised clearing house	a <i>clearing house</i> which is declared by a <i>recognition order</i> for the time being in force to be a recognised clearing house.
recognised investment exchange	an investment exchange which is declared by a <i>recognition order</i> for the time being in force to be a recognised investment exchange.
Regulated Activities Order	the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 SI 2001/544.
regulated activity	<p>(in accordance with section 22 of the <i>Act</i> (The classes of activity and categories of investment)) any of the following activities specified in Part II of the <i>Regulated Activities Order</i> (Specified Activities):</p> <p>(a) <i>accepting deposits</i> (article 5);</p> <p>(b) <i>effecting contracts of insurance</i> (article 10(1));</p> <p>(c) <i>carrying out contracts of insurance</i> (article 10(2));</p> <p>(d) <i>dealing in investments as principal</i> (article 14);</p> <p>(e) <i>dealing in investments as agent</i> (article 21);</p> <p>(f) <i>arranging (bringing about) deals in investments</i> (article 25(1));</p> <p>(g) <i>making arrangements with a view to transactions in investments</i> (article 25(2));</p> <p>(h) <i>managing investments</i> (article 37);</p> <p>(i) <i>safeguarding and administering investments</i> (article 40); (for the purposes of the <i>permission</i> regime, this is sub-divided into:</p> <p style="padding-left: 40px;">(i) <i>safeguarding and administration of assets (without arranging)</i>;</p> <p style="padding-left: 40px;">(ii) <i>arranging safeguarding and administration of assets</i>);</p> <p>(j) <i>sending dematerialised instructions</i> (article 45(1));</p> <p>(k) <i>causing dematerialised instructions to be sent</i> (article 45(2));</p> <p>(l) <i>establishing, operating or winding up a collective investment scheme</i> (article 51(1)(a)); (for the purposes of the <i>permission</i> regime, this is sub-divided into:</p> <p style="padding-left: 40px;">(i) <i>establishing, operating or winding up a regulated collective investment scheme</i>);</p> <p style="padding-left: 40px;">(ii) <i>establishing, operating or winding up an unregulated collective investment scheme</i>;</p> <p>(m) <i>acting as trustee of an authorised unit trust scheme</i> (article 51(1)(b));</p>

- (n) *acting as the depositary or sole director of an open-ended investment company* (article 51(1)(c));
- (o) *establishing, operating or winding up a stakeholder pension scheme* (article 52);
- (p) *advising on investments* (article 53); (for the purposes of the *permission* regime, this is sub-divided into:
 - (i) *advising on investments (except pension transfers and pension opt-outs)*;
 - (ii) *advising on pension transfers and pension opt-outs*;
- (q) *advising on syndicate participation at Lloyd's* (article 56);
- (r) *managing the underwriting capacity of a Lloyd's syndicate as a managing agent at Lloyd's* (article 57);
- (s) *arranging deals in contracts of insurance written at Lloyd's* (article 58);
- (t) *agreeing to carry on a regulated activity* (article 64);

which is carried on by way of business and either relates to a *specified investment*, or in the case of (l), (m), (n) and (o), is carried on in relation to property of any kind..

regulated collective investment scheme

- (a) an *ICVC*;
- (b) an *AUT*; or
- (c) a *recognised scheme*;

whether or not the *units* are held within a *PEP*, *ISA*, or *pension contract*.

regulated market

(as defined in article 1 of the *ISD*) a market for the instruments listed in Section B of the Annex to the *ISD* which:

- (a) appears on the list of such markets drawn up by the market's *Home State* as required by article 16 of the *ISD*;
- (b) functions regularly;
- (c) is characterised by the fact that regulations issued or approved by the competent authorities define the conditions for the operation of the market, the conditions for access to the market and, where Directive 79/279/EEC is applicable, the conditions governing admission to listing imposed in that Directive and, where that Directive is not applicable, the conditions that must be satisfied by a financial instrument before it can effectively be dealt in on the market; and
- (d) requires compliance with all the reporting and transparency requirements laid down by articles 20 and 21 of the *ISD*.

(see *SUP 17 Ann 5G* for a list of these markets)

related designated investment

(in relation to a *designated investment* (the "first investment")) a *designated investment* (the related designated investment) whose value might reasonably be expected to be directly affected by:

- (a) any fluctuation in the value of the first investment; or
- (b) any *published recommendation* that concerns the first investment.

relevant collateral

in relation to a transaction:

- (a) cash;
- (b) letters of credit and guarantees to the extent of their face value, issued by an *approved bank* which is neither a counterparty nor an *associate* of a counterparty;

- (c) gold and silver bullion and coinage;
- (d) *marketable investments*;
- (e) the performance guarantees issued in support of the securities lending and borrowing programmes of Euroclear and Clearstream, in respect only of *exposure* arising from participation in such programmes;

subject to:

- (i) the *firm* having an unconditional right to apply or realise the *relevant collateral* for the purpose of repaying a counterparty's obligations;
- (ii) *marketable investments*:
 - (A) being marked to market daily using the valuation *principles* in *IPRU(INV) 3.41(9)R*;
 - (B) not being issued by a counterparty nor by an *associate* of a counterparty.

representative	(in relation to <i>designated investment business</i>) an individual appointed by a <i>provider firm</i> or by an <i>appointed representative</i> of that <i>firm</i> , to carry out either or both of the following activities: <ul style="list-style-type: none"> (a) giving <i>advice on investments</i> to <i>customers</i> on the merits of <i>packaged products offered</i> by that <i>firm</i> (or any other <i>provider firm</i> within the same <i>marketing group</i>); (b) <i>arranging (bringing about) deals in investments</i> in relation to such products.
retirement fund	the amount which will be available, at the date on which the investor retires, for the provision of benefits.
rule	(in accordance with section 417(1) of the <i>Act</i> (Definitions)) a rule made by the <i>FSA</i> under the <i>Act</i> , including: <ul style="list-style-type: none"> (a) a <i>Principle</i>; and (b) an <i>evidential provision</i>.
safe custody investments	a <i>designated investment</i> , which is not the property of the <i>firm</i> , but for which the <i>firm</i> , or any <i>nominee company</i> controlled by the <i>firm</i> or by its <i>associate</i> , is accountable; which has been paid for in full by the <i>client</i> ; and which ceases to be a <i>safe custody investment</i> when the <i>firm</i> has disposed of it in accordance with a valid instruction.
scheme holding	a holding of: <ul style="list-style-type: none"> (a) <i>units</i> in a <i>collective investment scheme</i>; or (b) <i>shares</i> in an <i>investment trust savings scheme</i>.
scheme particulars	a <i>document</i> containing information about a <i>regulated collective investment scheme</i> .
securities and futures firm	a <i>firm</i> whose <i>permitted activities</i> include <i>designated investment business</i> , which is not an <i>authorised professional firm</i> , <i>bank</i> , <i>building society</i> , <i>credit union</i> , <i>friendly society</i> , <i>ICVC</i> , <i>insurer</i> , <i>media firm</i> , <i>service company</i> , <i>incoming EEA firm</i> (without a <i>top-up permission</i>), <i>incoming Treaty firm</i> (without a <i>top-up permission</i>) or <i>UCITS qualifier</i> , whose <i>permission</i> does not include a <i>requirement</i> that it comply with <i>IPRU(INV) 5</i> (Investment management firms) or 13 (Personal investment firms), and which is within (a), (b), (c) or (d): <ul style="list-style-type: none"> (a) a <i>firm</i> (other than one falling within (d)): <ul style="list-style-type: none"> (i) which was a member of <i>SFA</i> immediately before <i>commencement</i>; and (ii) which was not, immediately before <i>commencement</i>, subject to the

financial supervision requirements of the *FSA* (under section 43 of the Financial Services Act 1986), *PIA* or *IMRO* under lead regulation arrangements;

(b) a *firm* whose *permission* includes a *requirement* that it comply with *IPRU(INV)* 3 or 10 (Securities and futures firms);

(c) a *firm*:

(i) which was given a *Part IV permission* after *commencement*, or which was authorised under section 25 of the Financial Services Act 1986 immediately before *commencement* and not a member of *IMRO*, *PIA* or *SFA*; and

(ii) for whom the most substantial part of its gross income, including *commissions*, from the *regulated activities* included in its *Part IV permission* is derived from one or more of the following activities (based, for a *firm* given a *Part IV permission* after *commencement*, on the business plan submitted as part of the *firm's* application or, for a *firm* authorised under section 25 of the Financial Services Act 1986, on the *firm's financial year* preceding its *authorisation* under the Act);

(A) an activity carried on as a member of an exchange;

(B) making a market in *securities* or *derivatives*;

(C) *corporate finance business*;

(D) *dealing*, or *arranging (bringing about) deals in investments*, in *securities* or *derivatives*;

(E) the provision of clearing services as a *clearing firm*;

(F) *managing investments*, where those *investments* are primarily *derivatives*; and

(G) activities relating to *spread bets*;

(d) a *firm* that is:

(i) an *ex-section 43 firm* which was not authorised under the Financial Services Act 1986 immediately before *commencement*; or

(ii) an *ex-section 43 lead regulated firm*.

security

(in accordance with article 3(1) of the *Regulated Activities Order* (Interpretation)) any of the following *investments* specified in that Order:

(a) *share* (article 76);

(b) *debenture* (article 77);

(c) *government and public security* (article 78);

(d) *warrant* (article 79);

(e) *certificate representing certain securities* (article 80);

(f) *unit* (article 81);

(g) *stakeholder pension scheme* (article 82);

(h) *rights to or interests in investments* in (a) to (g) (article 89).

sell	<p>(in accordance with article 3(1) of the <i>Regulated Activities Order</i> (Interpretation)), in relation to any <i>investment</i>, sell in any way, including disposing of the <i>investment</i> for valuable consideration;</p> <p>in this definition, "disposing" includes:</p> <p>(a) (in relation to an <i>investment</i> consisting of rights under a contract):</p> <p style="padding-left: 20px;">(i) surrendering, assigning or converting those rights; or</p> <p style="padding-left: 20px;">(ii) assuming the corresponding liabilities under the contract;</p> <p>(b) (in relation to an <i>investment</i> consisting of rights under other arrangements) assuming the corresponding liabilities under the arrangements; and</p> <p>(c) (except in <i>COLL</i> and <i>CIS</i>) (in relation to any other <i>investment</i>) issuing or creating the <i>investment</i> or granting the rights or interests of which it consists.</p>
series of transactions	a series of transactions executed with a view to achieving one investment decision or objective.
service company	<p>a <i>firm</i> whose only <i>permitted activities</i> are <i>making arrangements with a view to transactions in investments</i>, and <i>agreeing to carry on that regulated activity</i>, and whose <i>Part IV permission</i>:</p> <p>(a) incorporates a <i>limitation</i> substantially to the effect that the <i>firm</i> carry on <i>regulated activities</i> only with <i>market counterparties</i> or <i>intermediate customers</i>; and</p> <p>(b) includes <i>requirements</i> substantially to the effect that the <i>firm</i> must not:</p> <p style="padding-left: 20px;">(i) guarantee, or otherwise accept responsibility for, the performance, by a participant in arrangements made by the <i>firm</i> in carrying on <i>regulated activities</i>, of obligations undertaken by that participant in connection with those arrangements; or</p> <p style="padding-left: 20px;">(ii) <i>approve any financial promotion</i> on behalf of any other <i>person</i> or any specified class of <i>persons</i>; or</p> <p style="padding-left: 20px;">(iii) in carrying on its <i>regulated activities</i>, provide services otherwise than in accordance with <i>documents</i> (of a kind specified in the <i>requirement</i>) provided by the <i>firm</i> to the <i>FSA</i>.</p>
share	<p>(1) the <i>investment</i>, specified in article 76 of the <i>Regulated Activities Order</i> (Shares etc), which is, in summary: a share or stock in the share capital of:</p> <p style="padding-left: 20px;">(a) any <i>body corporate</i> (wherever incorporated);</p> <p style="padding-left: 20px;">(b) any unincorporated body constituted under the law of a country or territory outside the <i>United Kingdom</i>.</p>
small self-administered scheme	an <i>occupational pension scheme</i> of a kind described in article 4(4) and 4(5) of the Financial Services and Markets Act 2000 (Carrying on Regulated Activities by Way of Business) Order 2001 (SI 2001/).
sole trader	an individual who is a <i>firm</i> .
special adjustment	a <i>position</i> risk adjustment, counterparty risk adjustment, foreign <i>exchange</i> adjustment, and any <i>large exposure</i> adjustment in accordance with chapter 13;
specified investment	<p>any of the following <i>investments</i> specified in Part III of the <i>Regulated Activities Order</i> (Specified Investments):</p> <p>(a) <i>deposit</i> (article 74);</p> <p>(b) <i>contract of insurance</i> (article 75); (for the purposes of the <i>permission</i></p>

	<p>regime, this is sub-divided into:</p> <ul style="list-style-type: none"> (i) <i>general insurance contract</i>; (ii) <i>long-term insurance contract</i>; <p>and then further sub-divided into classes of <i>contract of insurance</i>);</p> <ul style="list-style-type: none"> (c) <i>share</i> (article 76); (d) <i>debenture</i> (article 77); (e) <i>government and public security</i> (article 78); (f) <i>warrant</i> (article 79); (g) <i>certificate representing certain securities</i> (article 80); (h) <i>unit</i> (article 81); (i) <i>stakeholder pension scheme</i> (article 82); (j) <i>option</i> (article 83); (for the purposes of the <i>permission</i> regime, this is sub-divided into: <ul style="list-style-type: none"> (i) <i>option</i> (excluding a <i>commodity option</i> and an <i>option</i> on a <i>commodity future</i>); (ii) <i>commodity option</i> and an <i>option</i> on a <i>commodity future</i>); (k) <i>future</i> (article 84); (for the purposes of the <i>permission</i> regime, this is sub-divided into: <ul style="list-style-type: none"> (i) <i>future</i> (excluding a <i>commodity future</i> and a <i>rolling spot forex contract</i>); (ii) <i>commodity future</i>); (iii) <i>rolling spot forex contract</i>; (l) <i>contract for differences</i> (article 85); (for the purposes of the <i>permission</i> regime this is sub-divided into: <ul style="list-style-type: none"> (i) <i>contract for differences</i> (excluding a <i>spread bet</i> and a <i>rolling spot forex contract</i>); (ii) <i>spread bet</i>; (iii) <i>rolling spot forex contract</i>); (m) <i>underwriting capacity of a Lloyd's syndicate</i> (article 86(1)); (n) <i>membership of a Lloyd's syndicate</i> (article 86(2)); (o) <i>rights to or interests in investments</i> (article 89).
subsidiary	(as defined in section 736 of the Companies Act 1985) (in relation to another <i>body corporate</i> ("H")) a <i>body corporate</i> of which H is a <i>holding company</i> .
surrender value	<ul style="list-style-type: none"> (a) where the contract is a contract of life assurance or a contract for an annuity, the amount (including a nil amount) payable by the <i>firm</i> or other body issuing the contract on surrender of the <i>policy</i>; (b) where the contract is a <i>pension contract</i>, the amount payable on the transfer of the investor's accrued rights under that contract to another <i>pension contract</i>; (c) where the contract is a <i>Holloway sickness policy</i>, the amount payable by the <i>firm</i> on surrender on or before the <i>projection date</i> for the <i>policy</i>; (d) where the contract is for any other matter, the amount payable by the <i>firm</i> on the surrender of the <i>policy</i>.
tax exempt policy	any contract of assurance, offered or issued by a <i>friendly society</i> , which is tax

	exempt life or endowment business as defined in section 466 (2) of the Income and Corporation Taxes Act 1988.
traded life policy	a <i>life policy</i> which is to be or has been assigned for value by the <i>policyholder</i> to another <i>person</i> .
traded option	(a) <i>investments</i> falling within article 77 of the RAO which relate to <ul style="list-style-type: none"> (i) <i>shares</i>, or (ii) <i>debt instruments</i>, or (b) <i>investments</i> falling within article 79 of the RAO which are <i>options</i> on equity indices, <p>provided that those <i>investments</i> are traded on, or under the <i>rules</i> of, a <i>recognised</i> or <i>designated investment exchange</i>;</p>
unauthorised person	a <i>person</i> who is not an <i>authorised person</i> .
undertaking	(as defined in section 259 of the Companies Act 1985 (Meaning of undertaking and related expressions)): <ul style="list-style-type: none"> (a) a <i>body corporate</i> or <i>partnership</i>; or (b) an unincorporated association carrying on a trade or business, with or without a view to profit.
unit	an <i>investment</i> (as specified in article 81 of the <i>Regulated Activities Order</i>) (Units in a collective investment scheme) and defined in section 237(2) of the <i>Act</i> (Other definitions) which is the right or interest (however described) of the <i>participants</i> in a <i>collective investment scheme</i> ; this includes: <ul style="list-style-type: none"> (a) (in relation to an <i>AUT</i>) <ul style="list-style-type: none"> a unit representing the rights or interests of the <i>unitholders</i> in the <i>AUT</i>; (b) (in relation to an <i>ICVC</i>) <ul style="list-style-type: none"> a <i>share</i> in the <i>ICVC</i>.
unit trust scheme	(as defined in section 237(1) of the <i>Act</i> (Other definitions)) a <i>collective investment scheme</i> under which the property in question is held on trust for the <i>participants</i> .
unregulated collective investment scheme	a <i>collective investment scheme</i> which is not a <i>regulated collective investment scheme</i> .
verified	(where interim net profits are to be included in Financial Resources Test 1 (own funds) checked by an external auditor who has undertaken at least to <ul style="list-style-type: none"> (a) satisfy himself that the figures forming the basis of the interim profits have been properly extracted from the underlying accounting records, (b) review the accounting <i>policies</i> used in calculating the interim profits so as to obtain comfort that they are consistent with those normally adopted by the <i>firm</i> in drawing up its <i>annual financial statements</i> and are in accordance with the accounting principles set out in chapter 13, (c) perform analytical procedures on the result to date, including comparisons of actual performance to date with budget and with the results of prior period(s), (d) discuss with management the overall performance and financial <i>position</i> of the <i>firm</i>, obtain adequate comfort that the implications of current and prospective litigation, all known claims and commitments, changes in business activities and provisioning for bad and doubtful debts have been properly taken into

account in arriving at the interim profits, and follow up problem areas of which he is already aware in the course of auditing the *firm's* financial statements,

a copy of whose report asserting that the interim net profits are reasonably stated has been submitted to the *FSA*;

warrant the *investment* specified in article 79 of the *Regulated Activities Order* (Instruments giving entitlements to investments), which is, in summary: a warrant or other instrument entitling the holder to subscribe for a *share*, *debenture* or *government and public security*.

whole life assurance a *contract of insurance* which, disregarding any benefit payable on surrender, secures a capital sum only on death or either on death or on disability, but does not include a term assurance.

Zone A country all *EEA States* and all other countries which are full members of the *OECD* and those countries which have concluded special lending arrangements with the International Monetary Fund associated with the Fund's General Arrangements to Borrow.

CHAPTER 14: CONSOLIDATED SUPERVISION FOR INVESTMENT BUSINESSES

14.1 Application

14.1.1 R Subject to rule 14.1.2, *consolidated supervision* and this chapter apply to a *firm* which is a member of a group if:

- (1) It is:
 - (a) a *securities and futures firm*, subject to the financial rules in Chapter 3, which is a *broad scope firm* but not a *venture capital firm*;
 - (b) a *securities and futures firm*, subject to the financial rules in Chapter 10, unless the *firm* is a *category D firm*; or
 - (c) a *category personal investment firm*, subject to the financial rules in Chapter 13; and
- (2) It is not a *BIPRU firm*.
- (3) [Deleted]
- (4) [Deleted]
- (5) [Deleted]

Cases where consolidated supervision under this chapter will not apply

14.1.2 R A *firm* is not subject to *consolidated supervision* under the rules in this Chapter where any of the following conditions are fulfilled:

- (1) the *firm* is included in the supervision on a consolidated basis of the group of which it is a member by a *competent authority* other than the *FSA*; or
- (2) the *firm* is a member of a *UK consolidation group* already included in the supervision on a consolidated basis of the group of which it is a member by the *FSA* under *BIPRU 8*.

14.1.3 G

- (1) [Deleted]
- (2) [Deleted]
- (3) Where there is more than one authorised *firm* in the group, subject to the rules of this chapter, one consolidated supervision return may be submitted on behalf of all the *firms* in the group in accordance with *SUP 16.3.25G*.

Exemption from consolidated supervision

14.1.4 R A *firm* need not meet the requirements in rules 14.3.1 and 14.3.2 if:

- (1) there is no *credit institution* in the group;
- (2) no *firm* in the group *deals in investments as principal*, except where it is an *operator* of a *collective investment scheme* dealing solely as a result of its activity of operating a *collective investment scheme*, or where the *firm's* positions fulfil the *CAD Article 3 exempting criteria*;
- (3) [Deleted]
- (4) the *firm* notifies the *FSA* of any serious risk that could undermine the financial stability of the group as soon as it becomes aware of that risk;
- (5) the *firm* reports to the *FSA* all group *large exposures* as at the end of each quarter, and within the period specified in *SUP 16*;
- (6) the *firm* meets the conditions in rule 14.1.5; and

- (7) the *firm* has first notified the *FSA* in writing that it intends to rely on this rule.

14.1.5 R If the *firm* notifies the *FSA* under *rule* 14.1.4 that it will not apply the rules in this section, it must:

- (1) submit to *FSA* a consolidated supervision return within the time period specified by *SUP* 16, together with a consolidated profit and loss account;
- (2) ensure that each *firm* in the group deducts from its solo financial resources any quantifiable *contingent liability* in respect of other group entities;
- (3) ensure that the solo financial resources requirement of each *firm* in the group incorporates the full value of the expenditures of the *firm* wherever they are incurred on behalf of the *firm*; and
- (4) make a note in its audited financial statements that it is not subject to regulatory consolidated capital requirements.

14.1.6 G (1) [Deleted]

- (2) The conditions in *rule* 14.1.5 aim to ensure that the *firm* is protected from weaknesses in other group entities.
- (3) In *rule* 14.1.5(2), *contingent liabilities* includes direct and indirect guarantees.
- (4) 14.1.5(3) aims to ensure that the expenditure-based requirement incorporates the *firm's* actual ongoing annual expenditures (including any share of depreciation on fixed assets) where these have been met by another group entity.
- (5) The *FSA* may require further information from the *firm* if it considers that the *firm's* consolidated financial position raises undue risks to consumers. It may also seek reassurance that the *firm* has sufficiently robust *client money* and asset controls - for example, it may require a *skilled person's* report. The *FSA* may also use its *own initiative power* to impose conditions on the *firm*. This could include raising additional capital or further limitations on the *firm's* intra-group exposures.

- (6) Rule 14.1.4(5) refers to *large exposures*, which should be measured against group consolidated own funds or (if this would result in all *exposures* being classified as *large exposures*) by aggregating all the *exposures* of the individual entities in the group and measuring them against the own funds of the individual *firm* giving rise to the consolidated supervision requirement. If there is more than one *firm* in the group giving rise to the consolidated supervision requirement, the group *large exposures* should be measured against the *firm* with the smallest own funds.

14.2 Scope of consolidation

14.2.1 R For the purposes of the rules in this chapter, a *firm's* group means the *firm* and:

- (1) any *EEA parent* in the group which is a *financial holding company*, a *credit institution*, or an *investment firm*;
- (2) any *credit institution*, *investment firm* or *financial institution* which is a *subsidiary* either of the *firm* or of the *firm's EEA parent* as defined in (1); and
- (3) any *credit institution*, *investment firm* or *financial institution* in which the *firm* or one of the entities in (1) or (2) holds a *participation*.

14.2.2 R If a group exists under rule 14.2.1, the *firm* must also include in the scope of consolidation any *ancillary services undertaking* and *asset management company* in the group.

14.2.3 G Rule 14.1.1 states what type of *firm* may be subject to consolidated supervision (trigger firm). Rule 14.2.1 states what type of relationship triggers the existence of a group for consolidated supervision purposes. Rules 14.2.1 and 14.2.2 specify what entities should be included in the scope of consolidated supervision.

14.2.4 G (1) A *firm's parent* is a *financial holding company* if it is either a *financial institution* or a *securities and futures firm* that is subject to the financial rules in Chapter 3 and that is a *broad scope firm* (but not a *venture capital firm*) and if its *subsidiary undertakings* carry out mainly *listed activities*, activities of a *credit institution* or activities undertaken by a Chapter 3 *broad scope firm*. For this purpose the *FSA* interprets the phrases 'mainly' or 'main business' to mean where the balance of business is over 40% of the relevant group or sub-group's balance sheet (measured on the basis of total assets) or profit and loss statement (measured on the basis of gross income). In addition, if the *firm's parent* has significant holdings in *insurance undertakings* or *reinsurance undertakings*, it is a *mixed financial holding company*, and the *firm* is subject to the rules in GENPRU 3.1 instead of the rules in this chapter. This is because a *parent* cannot be a *financial holding company* and a *mixed financial holding company* at the same time. GENPRU 3.1 sets out what constitutes significant insurance holdings (broadly more than 10% of the financial sector activities of the group). A *firm's parent* is a *financial holding company* and not regarded as a *mixed financial holding company* unless:

- (a) the *parent* has been notified by its *coordinator* that the group it heads is a *financial conglomerate* (in accordance with Article 4(2) of the *Financial Groups Directive*); and
- (b) it has not been notified that the *coordinator* and the *relevant competent authorities* have agreed not to treat the group as a *financial conglomerate* in accordance with Article 3(3) of the *Financial Groups Directive*.

14.2.4(2) G A *firm* with an ultimate non-EEA parent may also be subject to the provisions in GENPRU 3.2.

14.2.4(3) G In the case where undertakings are linked to the domain of consolidation by a relationship within the meaning of article 12(1) of Directive (83/349/EEC), the *FSA* will determine how consolidation is to be carried out.

Exclusions

14.2.5 R A *firm* may, having first notified the *FSA* in writing, exclude from its group the following:

- (1) any entity the total assets of which are less than the smaller of the following two amounts:
 - (a) 10 million euros; or
 - (b) 1% of the total assets of the group's *parent* or the undertaking that holds the *participation*;

provided that the total assets of such entities do not collectively breach these limits.

- (2) any entity the inclusion of which within the group would be misleading or inappropriate for the purposes of *consolidated supervision*.

14.2.6 G (1) The *FSA* may require a *firm* to provide information about the position in the group of any undertaking excluded from the consolidation under rule 14.2.5.

- (2) An exclusion under rule 14.2.5(2) would normally be appropriate when an entity would be excluded from the scope of consolidation under the relevant UK generally accepted accounting principles.

14.3 Consolidated supervision requirement

14.3.1 R A *firm* must at all times ensure that its group maintains *group financial resources* in excess of its *group financial resources requirement*.

14.3.2 R A *firm*, other than one which is defined in rule 14.1.1(1), must at all times comply with *large exposures* limits applied on a group basis.

14.4 Group financial resources

14.4.1 R A *firm* must calculate its *group financial resources* on the basis of the consolidated accounts of the relevant group, subject to the adjustments in rule 14.4.2 and on the basis specified in rule 14.4.3.

- 14.4.2 R
- (1) If more than one *firm* in the group is subject to the rules of this chapter, *group financial resources* are defined according to the relevant rules applicable to the main *firm* in the group to which this chapter applies, with Tier 1 minority interests being allowed as Group Tier 1 capital and Tier 2 minority interests being allowed as Group Tier 2 capital.
 - (2) In calculating the *group financial resources*, deductions should be made for intangible assets, material unaudited losses incurred since the balance sheet date and investments in own shares.
 - (3) *Material holdings* and *material insurance holdings* must be recalculated on a group basis and deducted in arriving at the *group financial resources*.

14.4.3 R Financial resources will be defined based upon the main *firm* in the group to which this chapter applies as follows:

- (1) if a *broad scope securities and futures firm* (excluding a *venture capital firm*), Table 3-61R;
- (2) [Deleted]
- (3) [Deleted]
- (4) if an *ISD securities and futures firm*, Table 10-62(2)AR, but excluding any adjustment in (E) of that Table;
- (5) if a *personal investment firm*, Table 13.3.2(1)R.

- 14.4.4 G
- (1) The *FSA* interprets ‘main’ by reference to the share of the *firm*’s business in the group, its contribution to the group’s balance sheet (measured on the basis of total assets) or profit and loss statement (measured on the basis of gross income).
 - (2) The form in *SUP 16 Ann 19 R*, together with the guidance in *SUP 16 Ann 20G*, shows the mechanics of the calculation.

14.4.5G A *firm* may apply for a *waiver* of rule 14.4.1 to permit an aggregation approach to determine *group financial resources*. Any *waiver* application should guarantee future compliance with any relevant own funds limit.

14.5 Group financial resources requirement

14.5.1 R A *firm* must calculate its *group financial resources requirement* as the aggregate of:

- (1) the sum of the financial resources requirements of all group entities within the scope of consolidation calculated in accordance with rule 14.5.2, except that:
 - (a) requirements in respect of intra-group balances with other entities within the scope of consolidation should be excluded;
 - (b) *large exposures requirements* of individual group entities should be excluded;
- (2) the sum of any adjustments that are made to each *firm's* financial resources, calculated on a solo basis in accordance with rule 14.4.3, in order to arrive at the amount of financial resources used to meet its solo financial resources requirement. These adjustments must exclude deductions in respect of the investment in and other relationships with other entities that are included within the scope of consolidation; and:
- (3) if the main *firm* in the group is a *securities and futures firm* under rule 14.1.1(4), a group *large exposures requirement*.

The financial resources requirements of entities in which the group holds a *participation* must be included proportionately.

14.5.2 R Financial resources requirements for individual entities in the group are:

- (1) for *firms* regulated by the *FSA*, their regulatory capital requirement under *FSA* rules;
- (2) for entities regulated by an *EEA regulator* and which is subject to the local regulatory capital requirement of that regulator, that local regulatory capital requirement;
- (2A) for entities that are *recognised third country credit institutions* or *recognised third country investment firms* and which is subject to the local regulatory capital requirement of that regulator, that local regulatory capital requirement;
- (2B) for entities not in (2A) that are regulated by a *third country competent authority* named in the table in *BIPRU 8 Annex 3R ad* which is subject to the local regulatory capital requirement of that regulator, that local regulatory capital requirement; and
- (3) for other entities in the group, a notional financial resources requirement calculated as if the entity were regulated by the *FSA*.

- 14.5.3 G (1) For the purposes of rule 14.5.2(3) the notional financial resources requirements of group entities should normally be calculated as if the entities were subject to the financial rules in IPRU(INV) relevant to the main *firm* in the group. The interpretation of 'main' given in 14.4.4 G applies here.
- (2) For the purposes of calculating an expenditure-based requirement, no account should be taken of expenses that have been recharged to another entity included in the scope of consolidation. For example, in calculating the notional requirement for a service company, the expenditure-based requirement should be calculated net of recharged expenses. This is to avoid double counting of the expenses.
- (3) In 14.5.1(2), the adjustments referred to, are for *investment management firms*, the illiquid assets and qualifying property adjustments, and for *securities and futures firms*, the adjustments referred to in item (E) of Table 10-62(2)A. For *personal investment firms*, the adjustment required by 14.5.1(1) and (2) combined is the higher of:
- (a) the own funds requirement in 13.3.1R or 13.10.1R and;
 - (b) the sum of the relevant expenditure-based requirement and illiquid assets, position risk, and counterparty risk adjustments required by Chapter 13 of IPRU(INV).

14.5.4G A *firm* may apply for a *waiver* of rule 14.5.1R, to permit a line-by-line approach to determine its *group financial resources requirement*. A *firm* should also demonstrate that calculating its requirement in this way does not result in a distortion of the *group financial resources requirement*.

APPENDIX 14(1) (INTERPRETATION)

Glossary of defined terms for Chapter 14

If a defined term does not appear in the IPRU(INV) 14 glossary below, the definition appearing in the main Handbook *Glossary* applies.

<i>ancillary services undertaking</i>	an undertaking the principal activity of which consists of owning or managing property, managing data-processing services, or any other similar activity which is ancillary to the principal activity of one or more of the <i>firms</i> subject to this chapter.
<i>asset management company</i>	in accordance with Article 2(5) of the <i>Financial Groups Directive</i> (Definitions) a management company within the meaning of Article 1a(2) of the <i>UCITS Directive</i> , as well as an <i>undertaking</i> the registered office of which is outside the <i>EEA</i> and which would require authorisation in accordance with Article 5(1) of the <i>UCITS Directive</i> if it had its registered office within the <i>EEA</i> .
<i>broad scope firm</i>	as in the Glossary in IPRU(INV) chapter 3.
<i>CAD Article 5 exempting criteria</i>	the following criteria in respect of the <i>firm's</i> dealing positions: <ul style="list-style-type: none">- such positions arise only as a result of the <i>firm's</i> failure to match investors orders precisely;- the total market value of all such positions is subject to a ceiling of 15% of the <i>firm's</i> initial capital; and- such positions are incidental and provisional in nature and strictly limited to the time required to carry out the transaction in question.
<i>CAD investment firm</i>	a <i>firm</i> subject to the requirements of the <i>Capital Adequacy Directive</i> excluding a person to whom the CAD does not apply under Article 3.1(b) of that Directive.
<i>Category A personal investment firm</i>	as in the Glossary in IPRU(INV) chapter 13.
<i>Category D firm</i>	as in the Glossary in IPRU(INV) chapter 10.
<i>contingent liability</i>	the meaning in FRS 12 which states that it is: <ul style="list-style-type: none">(a) a possible obligation that arises from past events and whose existence will be confirmed only by the occurrence of one or more uncertain future events not wholly within the entity's control or(b) a present obligation that arises from past events but is not recognised because:<ul style="list-style-type: none">(i) it is not probable that a transfer of economic benefits will be required to settle the obligation; or(ii) the amount of the obligation cannot be measured with

sufficient reliability.

<i>consolidated supervision</i>	the application of the financial rules in the Interim Prudential sourcebook for investment businesses in accordance with rules and guidance in 14.1.1 to 14.5.4.
<i>EEA parent</i>	a <i>firm's</i> direct or indirect <i>parent</i> which has its head office in the <i>EEA</i> .
<i>financial holding company</i>	<p>an undertaking that satisfies the following conditions:</p> <p>(a) it is:</p> <ol style="list-style-type: none">i. a <i>financial institution</i>; orii. a <i>firm</i> falling within <i>IPRU(INV) rule 14.1.1(1)</i>; <p>(b) is <i>subsidiary undertakings</i> are either exclusively or mainly:</p> <ol style="list-style-type: none">i. <i>credit institutions</i>;ii. <i>investment firms</i>;iii. <i>broad scope firms</i> or <i>undertakings</i> carrying on activities which (if they were <i>firms</i> doing those activities in the <i>United Kingdom</i>) would make them <i>broad scope firms</i>; andiv. <i>financial institutions</i>; <p>one of which at least is a <i>credit institution</i>, a <i>firm</i> falling within <i>IPRU(INV) rule 14.1.1(1)</i> or an investment firm; and</p> <p>(c) it is not a <i>mixed financial holding company</i>.</p>
<i>financial institution</i>	an undertaking other than a <i>credit institution</i> , the principal activity of which is to acquire holdings or to carry on a <i>listed activity</i> .
<i>group of connected third parties</i>	as in the Glossary in <i>IPRU(INV) chapter 10</i> .
<i>group financial resources</i>	the resources of a <i>firm's</i> group calculated in accordance with rules 14.4 (Group financial resources).
<i>group financial resources requirement</i>	the requirement that a <i>firm's</i> group maintains financial resources calculated in accordance with the rules in 14.5 (Group financial resources requirement).
<i>investment firm</i>	<i>investment firm</i> as in the main <i>Glossary</i> except that it excludes persons to which the <i>ISD</i> does not apply as a result of article 2.2 of the <i>ISD</i> .
<i>large exposure</i>	<p>(a) in relation to <i>non-trading book exposures</i>, an <i>exposure</i> or number of <i>exposures</i> to a third party or <i>group of connected third parties</i> which exceed 10% of group consolidated own funds; and</p> <p>(b) in relation to the aggregate of <i>non-trading book</i> and <i>trading book exposures</i>, an <i>exposure</i> or number of <i>exposures</i> to a third party or <i>group of connected third parties</i> which exceed 10% of</p>

	<i>group financial resources;</i>
<i>large exposures requirement</i>	as set out in Rule 10-194 of IPRU(INV).
<i>listed activity</i>	<p>a listed activity within the meaning of the <i>BCD</i>, that is one or more of the following activities:</p> <ul style="list-style-type: none"> (a) lending; (b) financial leasing; (c) money transmission services; (d) issuing and administering means of payment; (e) guarantees and commitments; (f) trading for own account or for the account of customers in: <ul style="list-style-type: none"> (i) money market instruments (cheques, bills, certificates of deposit, etc); (ii) foreign exchange; (iii) financial futures and options; (iv) exchange and interest rate instruments; (v) transferable securities; (g) participation in share issues and the provision of services related to such issues; (h) corporate finance advice; (i) money broking; (j) portfolio management and advice; or (k) safekeeping and administration of securities.
<i>material holding</i>	<p>a holding of -</p> <ul style="list-style-type: none"> (a) ordinary share capital and non cumulative preference share capital; or (b) subordinated loan and non fixed-term cumulative preference share capital, <p>in a <i>credit institution</i> or a <i>financial institution</i> where -</p> <ul style="list-style-type: none"> (i) (a) or (b) above exceeds 10% of the share capital plus share premium of the issuer; or (ii) the aggregate of (a) and (b) above exceeds 10% of the <i>firm's own funds</i>, before deducting the holding.
<i>material insurance holding</i>	<p>the higher of –</p> <ul style="list-style-type: none"> (1) the book value of an <i>investment</i> held in an insurance undertaking, reinsurance undertaking, or insurance holding company (<i>investment</i> for this purpose is either a <i>participation</i> or the <i>investment</i> in a <i>subsidiary</i> undertaking); or (2) the group's proportionate share of that undertaking's local or notional regulatory capital requirement."
<i>non-trading book parent</i>	<p>as in the Glossary in IPRU(INV) chapter 10. any parent undertaking as defined in section 258 of the Companies Act 1985 and any undertaking which effectively exercises a dominant influence over another undertaking.</p>

<i>participation</i>	a participation within the meaning of Article 17 of Directive 78/660/EEC or the ownership either direct or indirect of 20% or more of the voting rights or capital of another undertaking which is not a <i>subsidiary</i> .
<i>securities and futures firm</i>	as in the Glossaries in IPRU(INV) chapter 3 and IPRU(INV) chapter 10.
<i>subsidiary</i>	as in section 736 of the Companies Act 1985.
<i>trading book</i>	as in the Glossary in IPRU(INV) chapter 10.
<i>venture capital firm</i>	as in the Glossary in IPRU(INV) chapter 3.

Annex A: LIMITED LIABILITY PARTNERSHIPS: ELIGIBLE MEMBERS' CAPITAL

1 Introduction

Application

- 1.1 R This annex applies to any *firm* :
- (1) that is a *limited liability partnership*; and
 - (2) that is a kind of *firm* to whom the provisions of this sourcebook apply, or which is a *UCITS firm*.
- 1.2 R In this annex, an expression in italics has the meaning given in the *Handbook Glossary*.
- 1.3 G (1) *Firms* are reminded that a *limited liability partnership* incorporated under the Limited Liability Partnership Act 2000 is a *body corporate* with legal personality separate to that of its members and is not therefore a form of *partnership* for the purposes of this sourcebook.
- (2) A *limited liability partnership* is not a separate prudential categorisation under this sourcebook but a kind of *firm* for whom the appropriate provisions of this sourcebook are modified to the extent indicated in this annex.

Purpose

- 1.4 G The purpose of this annex is to amplify *Principle 8* (Financial resources) which requires a *firm* to maintain adequate financial resources to meet its investment business commitments and to withstand the risks to which its business is subject. This annex imposes various conditions that must be satisfied for members' capital to count as "Tier 1" or equivalent grade capital in meeting the *limited liability partnership's* financial resources requirement. These conditions are made up of conditions specific to *limited liability partnerships* and general conditions based for the most part on those set out in article 57 of the *Banking Consolidation Directive*. This assists in the achievement of the *regulatory objectives* of consumer protection and market confidence.
- 1.5 G The following *rules* allow inclusion of members' capital within a *firm's* capital if it meets the conditions in this annex:

Chapter	<i>IPRU(INV) rule</i>	How <i>eligible LLP members' capital</i> should be treated for the purposes of the <i>IPRU(INV) rule</i>
3	Table 3-61	<i>Eligible LLP members' capital</i> may be counted as Tier 1 capital under item "A" within Table 3-61.
5	Table 5.2.2 (1):	<i>Eligible LLP members' capital</i> may be counted as

	Item (1A)	Tier 1 capital within Category A of Table 5.2.2(1).
10	Table 10-61(1)A Table 10-61(1)B Table 10-62(2)A Table 10-62(2)B Table 10-62(2)C	<i>Eligible LLP members' capital</i> may be counted as initial capital within the relevant table.
13	Table 13.3.2(1) Table 13.10(2)	<i>Eligible LLP members' capital</i> may be counted as <i>own funds</i> relating to companies in Table 13.3.2(1) and Table 13.10(2).

2. CONDITIONS FOR USE OF MEMBERS' CAPITAL

Members' capital of a limited liability partnership

2.1 R In this sourcebook, members' capital of a *limited liability partnership* may be included within a *firm's* resources if it complies with:

- (1) the specific conditions; and
- (2) the general conditions.

Specific conditions for eligibility

2.2 R The specific conditions are that:

- (1) members' capital is made up of the members' capital account; and
- (2) the members' capital account is an account:
 - (a) into which capital contributed by the members is paid; and
 - (b) from which under the terms of the *limited liability partnership* agreement an amount representing capital may be withdrawn by a member only if:
 - (i) he ceases to be a member and an equal amount is transferred to another such account by his former fellow members or any person replacing him as a member;
 - (ii) the *limited liability partnership* is wound up or otherwise dissolved; or
 - (iii) the *firm* has ceased to be *authorised* or no longer has a *Part IV* permission.

General conditions for eligibility

- 2.3 R The general conditions in respect of the members' capital are that:
- (1) it is fully paid and the proceeds are immediately and fully available to the *firm*;
 - (2) it is not capable of being redeemed at all (otherwise than in the circumstances set out in the specific conditions) or can only be redeemed on a winding up of the *firm*;
 - (3) any *coupon* is non-cumulative;
 - (4) it is able to absorb losses to allow the *firm* to continue trading;
 - (5) the amount of the item included is net of any foreseeable tax charge;
 - (6) it is available to the *firm* for unrestricted and immediate use to cover risks and losses as soon as they occur;
 - (7) it ranks for repayment on a winding up of the *firm* no higher than a *share* of a company incorporated under the Companies Act 1985 or the Companies (Northern Ireland) Order 1986 (whether or not it is such a *share*); and
 - (8) the *firm* is under no obligation to pay a *coupon* on it at any time.

Surplus eligible LLP members' capital

- 2.4 G If a *firm* has surplus *eligible LLP members' capital* that it wishes to repay in circumstances otherwise than those in the specific conditions, it may apply to the *FSA* for a *waiver* to allow it to do so. If a *firm* applies for such a *waiver* the information that the *firm* supplies to support the application might include:
- (1) a demonstration that the *firm* would have sufficient financial resources to meet its financial resources requirement immediately after the repayment; and
 - (2) a two to three year capital plan demonstrating that the *firm* would be able to meet the requirements in (1) and (2) at all times without needing further capital injections.

Limited liability partnership excess drawings

- 2.5 R A *firm* which is a *limited liability partnership* must in calculating its tier one capital in accordance with the requirements of any chapter of this sourcebook deduct the amount by which the aggregate of the amounts withdrawn by its members exceeds the profits of that *firm* ("*excess LLP members' drawings*"). Amounts of *eligible LLP members' capital* repaid in accordance with the specific conditions are not to be included in this calculation.

ANNEX D

[Required Forms]

Interim Prudential Sourcebook for Investment Businesses: Required Forms

[To be printed with FSA logo background]

These forms are the required forms referred to in IPRU(INV) and are listed below (a short contents list appears at the beginning of each section of the annex):

IPRU(INV) Chapter	FORM
2	Professional Firms
	2.1 Bond
3	Securities and Futures Firms which are not Investment Firms (former SFA Non-ISD Firms)
	3.1 Approved Form of Subordinated Loan Agreement
	3.2 Form of Deed of Termination
	3.3 Form of Deed of Variation
	3.4 Form of Guarantor Undertaking
	3.5 Guidance Notes
5	Investment Management Firms (former IMRO Firms)
	5.1 Prescribed Subordinated Loan Agreement
	5.2 Prescribed Approved Undertaking
10	Securities and Futures Firms which are Investment Firms (former SFA ISD Firms)
	10.1 Long Term Subordinated Loan Agreement
	10.2 Short Term Subordinated Loan Agreement
	10.3 Form of Deed of Termination
	10.4 Form of Deed of Variation
	10.5 Form of Guarantor Undertaking
	10.6 Long Term Consolidated Supervision Sub-Loan Agreement
	10.7 Short Term Consolidated Supervision Sub-Loan Agreement
	10.8 Guidance Notes
13	Personal Investment Firms (Former PIA Firms)
	13.1 Form of subordinated loan (with guidance notes)

2. Professional Firms

Form		Page
2.1	Form of Bond	2

**FORM OF BOND FOR PROFESSIONAL FIRMS
(SEE IPRU (INV) 2)**

BY THIS BOND AS A DEED WE [] of [] (“the Principal”) and [] of [] (“the Surety”) as witnessed by its common seal (so that the Surety whose seal is affixed below shall alone be bound) are jointly and severally bound upon the terms and conditions herein set out to [] (“the Trustee”) in the sum of £[] ([sum in words]) or such other sum as may from time to time be agreed between the Surety and the Principal (“the Penalty Sum”).

WHEREAS:-

- (1) The Trustee has consented to enter into this bond as trustee and to hold the rights and benefits under this bond upon trust for any Customer of the Principal in accordance with the terms of this bond.**
- (2) The Surety at the request of the Principal has agreed to be bound in the Penalty Sum upon the terms and conditions hereinafter contained.**

NOW THIS DEED WITNESSES as follows:-

- (1) For the purposes of this bond a claim shall arise if the following conditions are satisfied:-**
 - a. the Scheme has determined the Principal to be in default;**
 - b. the Trustee has determined to pay compensation to an eligible claimant whose claim is in respect of a Civil Liability incurred by the Principal in connection with its carrying on of Regulated Activities; and**
 - c. the claim in question relates to a Loss.**
- (2) The Surety and the Principal are held and firmly bound to the Trustee for the payment of any sum arising out of any claim under the provisions of Clause 1 hereof to the extent that any such claim exceeds the sum of fifty thousand pounds (£50,000) provided that the aggregate of any such sum or sums does not exceed the Penalty Sum.**
- (3) The Trustee hereby declares that it holds all its rights and benefits under this bond upon trust for the Customers in respect of whom or for which such claim or claims were made absolutely.**
- (4) The Trustee shall, insofar as it may lawfully do so, notify the Surety of any claim or Matter of which the Trustee is aware which may give rise to any claim hereunder such notice to be addressed to the Surety in writing at its address set out above or to such other address as may have been notified to the Trustee in writing by the Surety and any such information which the Trustee**

shall when serving such notice designate as confidential shall be held and retained by the Surety in confidence.

- (5) Payment of any sum to the Trustee in respect of any claim shall be due thirty (30) days after the giving of notice thereof pursuant to Clause 4 hereof the Surety shall pay any such sum or sums on demand.
- (6) The Surety may give written notice to the Trustee sent by recorded delivery service to the address set out above or such other address as the Trustee shall from time to time advise in writing (and serving a copy of such notice upon the Principal) terminating its liability under this bond which liability shall accordingly cease sixty (60) days after receipt by the Trustee in writing of such notice (“the Termination Date”) save in respect of any claim rising out of anything notified by the Trustee to the Surety pursuant to Clause 4 prior to or within the period of six months after the Termination Date.
- (7) Notwithstanding the Release or Discharge of the Principal the Surety shall remain liable in respect of any claim arising during the period in which this bond was in force or which shall be made within six months of the Termination Date.
- (8) The Principal and its executors administrators or representatives whosoever jointly and severally agree and covenant with the Surety and the Trustee as follows:-
 - a. That they shall and will from time to time and notwithstanding the Release or Discharge of the Principal indemnify the Surety and its successors and assigns from and against all claims losses costs and expenses which the Surety shall or otherwise might at any time sustain or be put to under or by virtue of this bond.
 - b. That the Principal is a Professional Firm which has Permission under the Act to carry on Regulated Activities and will give notice forthwith to the Surety in writing if it shall cease to have such Permission or if it shall become aware of any Matter which might give rise to it being declared in default by the Scheme.
 - c. That the Principal will calculate the Penalty Sum that may be required under this bond from time to time so as to ensure that it complies with the Rules.
 - d. That the persons named herein are duly authorised for an on behalf of the Principal to execute this bond in the manner appearing below.
 - e. That the Trustee is irrevocably authorised to provide such information to the Surety as it shall think fit or as may be required for the purpose of making any claim and the Surety is irrevocably authorised to provide such information to the Trustee in relation to the obligations of the Principal secured by this bond as it shall think fit.

f. That the Principal will duly and promptly pay the annual premium due in respect of this bond.

(9) In this bond words and expressions having capitalised initial letters shall have the meanings set out in this bond and where not so defined shall have the meanings set out in the Glossary annexed to the General Provisions Instrument 2001 and as the same may hereafter be varied amended or supplemented from time to time

“the Act”	means the Financial Services and Markets Act 2000 or any amendment or re-enactment of the provisions thereof;
“Civil Liability”	means a civil liability as defined in the Scheme Regulations;
“Customer”	means a customer as defined in the Scheme Regulations;
“Loss”	means a loss which has been the subject of a valid claim determined by the Scheme in respect of which the amount of the Civil Liability is in excess of £50,000;
“Matter”	means any proceedings initiated under the Act against the Principal in relation to its Regulated Activities;
“the Principal”	means the Professional Firm named herein and includes each of the partners thereof where applicable;
"Release or Discharge"	means the release of the Principal in relation to the termination of any Authorisation under the provisions of the Act;
“Scheme”	means the Financial Services Compensation Scheme;
"Scheme Regulations"	means the Financial Services Compensation Scheme Regulations.

Save where the context otherwise requires words and expressions used herein and in the Act shall bear the meaning given to them in the singular shall include the plural.

**IN WITNESS THEREOF the Principal acting by*
and*
as their duly authorised representatives and the Surety have executed and delivered
this bond as a deed this day of**

EXECUTED AND DELIVERED AS A DEED by

Witness
Signature
Occupation
Address
.....

EXECUTED AND DELIVERED AS A DEED by

Witness
Signature
Occupation
Address
.....

*** Where appropriate this bond should be executed by the compliance partner
 and the partner with overall responsibility for the Principal's Regulated
 Activities**

3. Securities and Futures Firms which are not Investment Firms (former SFA Non-ISD Firms)

Form		Page
3.1	Approved Form of Subordinated Loan Agreement	2
3.2	Form of Deed of Termination	17
3.3	Form of Deed of Variation	19
3.4	Form of Guarantor Undertaking	21
3.5	Guidance Notes	23
3.6	Form of Approved Bank Bond (with power of attorney)	31
3.7	Approved Form of Undertaking	34

3.1 Approved Form of Subordinated Loan Agreement

A. Front Page

THIS AGREEMENT is made on the date set out in the Variable Terms (as set out in **Schedule 1** to this Agreement) and is to be effective on that date unless a different effective date is set out in those terms

BETWEEN -

- (1) **the Lender** (as defined in the Standard Terms set out in **Schedule 2** to this Agreement), and
- (2) **the Borrower** (as defined in the Standard Terms)

WHEREAS the Borrower wishes to use the Loan, or each Advance under the Facility (as those expressions are defined in the Standard Terms) as an eligible capital substitute in accordance with the FSA's rule IPRU(INV) 3-63 and has fully disclosed to the FSA the circumstances giving rise to the Loan or Facility and the effective subordination of the Loan and each Advance.

IT IS AGREED THAT this Agreement shall comprise the Variable Terms set out in **Schedule 1** to this Agreement and the Standard Terms set out in **Schedule 2** to this Agreement.

This Agreement is executed by the parties the day and year indicated in the Variable Terms.

Schedule 1

B. Variable Terms

1. Date of Agreement	
2. Effective Date	
3. Lender	
4. Address of Lender	
5. Borrower	
6. Address of Borrower	

7. **The Loan or Facility**

With reference to paragraph 2 of the Standard Terms,

--

8. **Interest**

With reference to paragraph 3 of the Standard Terms, interest shall be calculated and paid as follows -

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9. **Repayment**

With reference to paragraph 4(2) of the Standard Terms and subject always to paragraphs 4(3) (restrictions on repayment) and 5 (subordination) of the Standard Terms, the terms for repayment are -

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10. **Additional terms**

With reference to paragraph 11 of the Standard Terms, the additional terms to this Agreement are -

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10. Additional terms (contd)

--	--

11. Jurisdiction

With reference to paragraph 16 of the Standard Terms, the person(s) indicated below is (are) appointed as agents for service of process -

(a) by the Lender -

--

of

--

(b) by the Borrower -

--

of

--

Schedule 2

C. Standard Terms

Interpretation

1 (1) In this Agreement -

“Advance” means, where this Agreement is for a loan facility, an amount drawn or to be drawn down by the Borrower or otherwise made available by the Lender under this Agreement as that amount may be reduced from time to time by any repayment or prepayment permitted under this Agreement;

“Borrower” means the person identified as such in the Variable Terms and includes its permitted successors and assigns and, where the Borrower is a partnership, each Partner;

“Business Day” means any day except Saturday, Sunday or a bank or public holiday in England;

“Effective Date” means the date on which this Agreement is to take effect being the date of this Agreement unless otherwise stated in the Variable Terms;

“Excluded Liabilities” means Liabilities which are expressed to be and, in the opinion of the Insolvency Officer of the Borrower, do, rank junior to the Subordinated Liabilities in the Insolvency of the Borrower;

“Facility” means the loan facility referred to in paragraph 2(2);

“Financial Resources” has the meaning given in the Financial Rules;

“Financial Resources Requirement” has the meaning given it in the Financial Rules;

“Financial Rules” means the rules in IPRU(INV) 3 in the FSA handbook;

“Insolvency” means and includes liquidation, winding up, bankruptcy, sequestration, administration, rehabilitation and dissolution (whichever term may apply to the Borrower) or the equivalent in any other jurisdiction to which the Borrower may be subject;

“Insolvency Officer” means and includes any person duly appointed to administer and distribute assets of the Borrower in the course of the Borrower’s Insolvency;

- 1 (1) **“Lender”** means the person identified as such in the Variable Terms and includes its permitted successors and assigns;

“Liabilities” means all present and future sums, liabilities and obligations payable or owing by the Borrower (whether actual or contingent, jointly or severally or otherwise howsoever);

“Loan” means the indebtedness of the Borrower to the Lender referred to in paragraph 2(1) as that indebtedness may be reduced from time to time by any repayment or prepayment permitted under this Agreement;

“Partner” means, where the Borrower is a partnership, each and every partner of the Borrower as a partner and as an individual (see also paragraph 8);

“Senior Liabilities” means all Liabilities except the Subordinated Liabilities and Excluded Liabilities;

“Subordinated Liabilities” means all Liabilities to the Lender in respect of the Loan or each Advance made under this Agreement and all interest payable thereon.

“the FSA” means The Financial Services Authority Limited whose registered office is at 25 The North Colonnade, Canary Wharf, London, E14 5HS; and

- (2) Any reference to any rules of the FSA is a reference to them as in force from time to time.
- (3) Reference to any gender includes a reference to all other genders.
- (4) Reference to a paragraph is to a paragraph of these Standard Terms, unless otherwise indicated.

The Loan or Facility

- 2 (1) Where as indicated in the Variable Terms this Agreement is for a loan, the Borrower hereby acknowledges its indebtedness to the Lender in the sum mentioned in the Variable Terms as an unsecured loan upon and subject to the terms and conditions of this Agreement.
- (2) Where, as indicated in the Variable Terms this Agreement is for a loan facility -
- (a) the maximum aggregate principal amount of each Advance outstanding at any time under the Facility shall not exceed the maximum amount specified in the Variable Terms or such other amount as may be agreed between the Borrower and the Lender from time to time;
- (b) the Facility will be available until the last available date specified in the Variable Terms; and

- 2** (2) (c) any specific terms dealing with the mechanics of drawdown are contained in the Variable Terms.
- (3) The Lender and the Borrower undertake to provide the FSA, immediately upon request, with details in writing of all principal and interest in respect of the Loan or each Advance outstanding for the time being and all payments of any amount made in the period specified by the FSA in the request.

Interest

- 3** Subject to the provisions of paragraphs 4 and 5, until repayment of the Loan or each Advance in full, the Borrower will pay to the Lender interest on the Loan or each Advance (or on any part or parts of it or them for the time being outstanding under this Agreement) calculated and payable in the manner set out in the Variable Terms.

Repayment

- 4** (1) The provisions of this paragraph are subject in all respects to the provisions of paragraph 5 (subordination).
- (2) The terms concerning repayment are set out in the Variable Terms but are subject to paragraph 4(3).
- (3) (a) Unless the FSA otherwise permits, no repayment or prepayment of the Loan or any Advance may be made, in whole or in part, until five Business Days have elapsed from the FSA confirming in writing to the Borrower receipt of the Borrower's written notice of his intention to do so, except that -
- (i) where, immediately after repayment or prepayment, the Borrower's Financial Resources would be less than or equal to 120% of its Financial Resources Requirement, the prior written approval of the FSA shall be obtained before any repayment or prepayment;
 - (ii) any notice under this sub-paragraph or the terms referred to in sub-paragraph (2) above shall be ineffective if -
 - (aa) the Insolvency of the Borrower commences before the date on which such notice expires; or
 - (bb) the FSA notifies the Borrower orally or in writing of its refusal to consent to such repayment or prepayment by the time such notice period expires.
- (b) Payments of interest at a rate not exceeding the rate provided for in paragraph 3 may be made without notice to or consent of the FSA, except that where -
- (i) immediately after payment, the Borrower's Financial Resources would be less than or equal to 120% of its Financial Resources Requirement; or

4 (3) (b) (ii) before payment, the Insolvency of the Borrower commences,
no such payment may be made without the prior written approval of the FSA.

(4) If in respect of the Loan or any Advance default is made for a period of -

(a) seven days or more in the payment of any principal due, or

(b) 14 days or more in the payment of any interest due,

the Lender may, at its discretion and after taking such preliminary steps or actions as may be necessary, enforce payment by instituting proceedings for the Insolvency of the Borrower after giving seven Business Day's prior written notice to the FSA of its intention to do so.

(5) Subject to (6) below, the Lender may at its discretion, subject as provided in this Agreement, institute proceedings for the Insolvency of the Borrower to enforce any obligation, condition or provision binding on the Borrower under this Agreement (other than any obligation for the payment of principal moneys or interest in respect the Loan or any Advance) PROVIDED THAT the Borrower shall not by virtue of the institution of any such proceedings for the Insolvency of the Borrower be obliged to pay any sum or sums sooner than the same would otherwise have been payable by it.

(6) The Lender may only institute proceedings for the Insolvency of the Borrower to enforce the obligations referred to in (5) above if -

(a) a default under those obligations is not remedied to the satisfaction of the Lender within 60 days after notice of such default has been given to the Borrower by the Lender requiring such default to be remedied;

(b) the Lender has taken all preliminary steps or actions required to be taken by it prior to the institution of such proceedings; and

(c) the Lender has given seven Business Days' prior written notice to the FSA of its intention to institute such proceedings.

(7) No remedy against the Borrower other than as specifically provided by this paragraph 4 shall be available to the Lender whether for the recovery of amounts owing under this Agreement or in respect of any breach by the Borrower of any of its obligations under this Agreement.

Subordination

- 5 (1) Notwithstanding the provisions of paragraph 4, the rights of the Lender in respect of the Subordinated Liabilities are subordinated to the Senior Liabilities and accordingly payment of any amount (whether principal, interest or otherwise) of the Subordinated Liabilities is conditional upon -
- (a) (if an order has not been made or an effective resolution passed for the Insolvency of the Borrower and, being a partnership, the Borrower has not been dissolved) the Borrower being in compliance with not less than 120% of its Financial Resources Requirement immediately after payment by the Borrower and accordingly no such amount which would otherwise fall due for payment shall be payable except to the extent that -
 - (i) paragraph 4(3) has been complied with; and
 - (ii) the Borrower could make such payment and still be in compliance with such Financial Resources Requirement;
 - (b) (if an order has been made or effective resolution passed for the Insolvency of the Borrower or, if a partnership, the Borrower is to be dissolved) the Borrower being “solvent” at the time of, and immediately after, the payment by the Borrower and accordingly no such amount which would otherwise fall due for payment shall be payable except to the extent that the Borrower could make such payment and still be “solvent”.
- (2) For the purposes of sub-paragraph (1)(b) above, the Borrower shall be “solvent” if it is able to pay its debts (other than the Subordinated Liabilities) in full disregarding -
- (a) obligations which are not payable or capable of being established or determined in the Insolvency of the Borrower, and
 - (b) the Excluded Liabilities.
- (3) Interest will continue to accrue at the rate specified pursuant to paragraph 3 on any payment which does not become payable under this paragraph 5.
- (4) For the purposes of sub-paragraph (1)(b) above, a report given at any relevant time as to the solvency of the Borrower by its Insolvency Officer, in form and substance acceptable to the FSA, shall in the absence of proven error be treated and accepted by the FSA, the Lender and the Borrower as correct and sufficient evidence of the Borrower’s solvency or Insolvency.

- 5** (5) Subject to the provisions of sub-paragraphs (6), (7) and (8) below, if the Lender shall receive from the Borrower payment of any sum in respect of the Subordinated Liabilities -
- (a) when any of the terms and conditions referred to in sub-paragraph (1) above is not satisfied, or
 - (b) where such payment is prohibited under paragraph 4(3),
- the payment of such sum shall be void for all purposes.
- (6) Any sum referred to in sub-paragraph (5) above shall be received by the Lender upon trust to return it to the Borrower.
- (7) Any sum so returned shall then be treated for the purposes of the Borrower's obligations hereunder as if it had not been paid by the Borrower and its original payment shall be deemed not to have discharged any of the obligations of the Borrower hereunder.
- (8) A request to the Lender for return of any sum referred to in sub-paragraph (5) shall be in writing and shall be made by or on behalf of the Borrower or, as the case may be, its Insolvency Officer.

Representations and undertakings of Borrower

- 6** From and after the date of this Agreement (or the Effective Date if earlier), the Borrower shall not without the prior written consent of the FSA -
- (a) secure all or any part of the Subordinated Liabilities;
 - (b) redeem, purchase or otherwise acquire any of the Subordinated Liabilities;
 - (c) amend any document evidencing or providing for the Subordinated Liabilities;
 - (d) repay any of the Subordinated Liabilities otherwise than in accordance with the terms of this Agreement;
 - (e) take or omit to take any action whereby the subordination of the Subordinated Liabilities or any part thereof to the Senior Liabilities might be terminated, impaired or adversely affected; or
 - (f) arrange or permit any contract of suretyship (or similar agreement) relating to its liabilities under this Agreement to be entered into, and
- other than as disclosed in writing to the FSA, the Borrower represents that it has not done so before the date of this Agreement (or the Effective Date if earlier).

Representations and undertakings of Lender

- 7** From and after the date of this Agreement (or the Effective Date if earlier), the Lender shall not without the prior written consent of the FSA -
- (a) assign, transfer, dispose of or encumber the whole or any part of the Subordinated Liabilities or purport to do so in favour of any person;
 - (b) purport to retain or set off at any time any amount payable by it to the Borrower against any amount of the Subordinated Liabilities except to the extent that payment of such amount of the Subordinated Liabilities would be permitted at such time by this Agreement, and the Lender shall immediately pay an amount equal to any retention or set off in breach of this provision to the Borrower and such retention or set off shall be deemed not to have occurred;
 - (c) amend or waive the terms of any document evidencing or providing for the Subordinated Liabilities;
 - (d) attempt to obtain repayment of any of the Subordinated Liabilities otherwise than in accordance with the terms of this Agreement;
 - (e) take or omit to take any action whereby the subordination of the Subordinated Liabilities or any part of them to the Senior Liabilities might be terminated, impaired or adversely affected; or
 - (f) take or enforce any security, guarantee or indemnity from any person for all or any part of the Subordinated Liabilities, and the Lender shall, upon obtaining or enforcing any security, guarantee or indemnity notwithstanding this undertaking, hold the same (and any proceeds thereof) on trust for the Borrower, and

other than as disclosed in writing to the FSA, the Lender represents that it has not done so before the date of this Agreement (or the Effective Date if earlier).

Borrower being a partnership

- 8** Where the Borrower is a partnership -
- (a) this Agreement shall subsist in full force and effect notwithstanding any change which may take place from time to time in the constitution or title of the Borrower by the retirement of the present Partners or any of them or the assumption of new Partners or by a change of name PROVIDED THAT -
 - (i) a retired Partner shall continue to be liable for the payment of all sums due under this Agreement and implementation of all other obligations in this Agreement until the Lender and the remaining Partner(s) shall agree in writing to release a retired Partner from those obligations and the FSA has agreed in writing to the release; and

- 8 (a) (ii) in the event of a new Partner being assumed as a partner of the Borrower the other Partners shall procure that said assumed Partner shall become bound to the Lender as a party to this Agreement and shall execute such addendum hereto as the Lender and the FSA may consider necessary;
- (b) the obligations and undertakings of the Borrower under this Agreement shall bind the Borrower and the Partners jointly and severally.

Partial invalidity

- 9 If any of the provisions of this Agreement is or becomes invalid, illegal or unenforceable under any law, the validity, legality and enforceability of the remaining provisions shall not in any way be affected or impaired.

The FSA and indemnity

- 10 The FSA shall not, by virtue of having rights under this Agreement, be taken to be a trustee for, or have any obligations to, any person to whom some or all of the Senior Liabilities are owed. Each of the Lender and Borrower shall on demand indemnify the FSA against all claims, losses, costs, expenses and other liabilities made against or incurred by the FSA as a consequence of it having rights, or taking action under this Agreement.

Additional terms

- 11 Any additional terms agreed between the parties are set out in the Variable Terms provided that, if there is any inconsistency between the Variable Terms and the Standard Terms, the Standard Terms shall prevail.

Entire agreement

- 12 This Agreement forms the entire agreement as to the Subordinated Liabilities. If there are any other terms relating to the Subordinated Liabilities existing at the date hereof and not comprised in this Agreement such terms shall be of no further force and effect.

Amendments

- 13 Any amendments to this Agreement must be made by the prescribed Deed of Variation and any amendments made or purported to be made without the consent of the FSA shall be void. For the avoidance of doubt, nothing in this paragraph requires the FSA to be a party to this Agreement.

Notices to the FSA

- 14** A notice given to the FSA under this Agreement shall have no effect, and time shall not start to run in connection with that notice, until the FSA has given to the sender written confirmation of its receipt.

Law

- 15** This Agreement is governed by English law.

Jurisdiction

- 16** For the benefit of the FSA solely, each of the Borrower and the Lender irrevocably submits to the jurisdiction of the English Courts and, to the extent that it does not have a place of business within the jurisdiction, appoints the process agent specified in the Variable Terms as agent for receipt of service of process in such courts. Such jurisdiction shall be non-exclusive except to the extent that non-exclusivity prejudices the submission to the jurisdiction.

Rights of the FSA

- 17** Although not a party to the Agreement, the FSA may in its own right enforce a term of the Agreement to the extent that it purports to confer upon the FSA a benefit.

3.2 FORM OF DEED OF TERMINATION

THIS DEED OF TERMINATION is made on the day of 20.....

BETWEEN -

- (1) * [insert full name of Lender] (registered in [England] number *) whose registered office is at [*if an individual or partnership* of] * (“the **Lender**”).
- (2) * [insert full name of Borrower] (registered in [England] number *) whose registered office is at [*if an individual or partnership* of] * (“the **Borrower**”).
- (3) **The Financial Services Authority Limited** (registered in England number 1920623) whose registered office is at 25 The North Colonnade, Canary Wharf, London, E14 5HS (“the **FSA**”).

WHEREAS -

A subordinated loan agreement was entered in between the Lender (1); the Borrower (2); and the FSA (3) on [date] (“the Agreement”) pursuant to which the Lender agreed to make available to the Borrower a [Loan/Facility] of up to [£]. [insert brief details of any Variations] The parties to the Agreement now wish to terminate the Agreement.

IT IS AGREED THAT -

1. The Agreement shall be deemed terminated [in accordance with its terms] with effect from [the date of this Deed of Termination/insert relevant future date]. All obligations and liabilities arising before that date shall remain continuing.
2. This Deed is governed by English Law.

IN WITNESS WHEREOF this Deed has been executed by the parties and is intended to be and is hereby delivered on the date first above written.

Executed as a deed by [full name of Lender]

.....

Signed
Director

Signed
Director/Secretary

or

Signed as a deed by
[full names of individual partners of Lender]

(as such partners and as individuals)

Signed
Partner

Signed.....
Partner/Witness

or

Signed as a deed by [full name of Lender]
(if an individual)

Signed.....

in the presence of

Signed.....
Witness

Executed as a deed by [full name of Borrower]

.....

Signed
Director

Signed
Director/Secretary

or

Signed as a deed by [full names of individual
partners of Borrower]
(as such partners and as individuals)

Signed.....
Partner

Signed.....
Partner/Witness

or

Signed as a deed by [full name of Borrower]
(*if an individual*)

Signed.....

in the presence of

Signed.....
Witness

The Common Seal of THE FINANCIAL
SERVICES AUTHORITY LIMITED
was hereunto affixed in the
presence of

Signed
Authorised Signatory

Signed
Authorised Signatory

3.3 FORM OF DEED OF VARIATION

THIS DEED OF VARIATION is made on the day of 20.....

BETWEEN -

- (1) * [insert full name of Lender] (registered in [England] number *) whose registered office is at [*if an individual or partnership of*] * (“the **Lender**”);
- (2) * [insert full name of Borrower] (registered in [England] number *) whose registered office is at [*if an individual or partnership of*] * (“the **Borrower**”); and
- (3) **The Financial Services Authority Limited** (registered in England number 1920623) whose registered office is at 25 The North Colonnade, Canary Wharf, London, E14 5HS (“**the FSA**”).

WHEREAS -

A subordinated loan agreement was entered into between the Lender (1); the Borrower (2); and the FSA (3) on [date] (“the Agreement”) pursuant to which the Lender agreed to make available to the Borrower a [Loan/Facility] of up to [£].

The parties to the Agreement now wish to vary the Agreement to [insert brief details].

IT IS AGREED THAT -

1. The Agreement shall be deemed varied [, in accordance with its terms,] from [the date of this Deed of Variation/insert relevant future date] so that the FSA is no longer a party to the agreement. Any obligation owed to or by, and any requirement for any consent or permission to be given to or by FSA shall be of no further effect. FSA is hereby released from each and every obligation owed by it under the Agreement. Although on execution of this deed the FSA is no longer a party to the Agreement, it may in its own right enforce a term of the Agreement to the extent that it purports to confer upon the FSA a benefit.

[insert additional clauses/details of amended clauses].

[to the extent that any term of the Agreement is inconsistent with their terms and conditions contained in the Approved Form, the terms and conditions in the Approved Form shall prevail (provided that for the purposes of this clause 1, in clauses 11 and 12 of the Approved Form, the expressions “Variable Terms” and “Agreement” shall be deemed to include references to the Agreement and this Deed)]*

2. All other terms and conditions of the Agreement remain unchanged.
3. This Deed is governed by English Law.

IN WITNESS WHEREOF this Deed has been executed by the parties and is intended to be and is hereby delivered on the date first above written.

Executed as a deed by [full name of Lender]

.....

Signed
Director

Signed
Director/Secretary

or

Signed as a deed by
[full names of individual partners of Lender]
(as such partners and as individuals)

Signed.....
Partner

Signed.....
Partner/Witness

or

Signed as a deed by [full name of Lender]
(if an individual)

Signed.....

in the presence of

Signed.....
Witness

Executed as a deed by [full name of Borrower]

.....

Signed
Director

Signed
Director/Secretary

or

Signed as a deed by [full names of individual

partners of Borrower]
(as such partners and as individuals)

Signed.....
Partner

Signed.....
Partner/Witness

or

Signed as a deed by [full name of Borrower]
(if an individual)

Signed.....

in the presence of

Signed.....
Witness

The Common Seal of THE FINANCIAL
SERVICES AUTHORITY LIMITED
was hereunto affixed in the
presence of

Signed
Authorised Signatory

Signed
Authorised Signatory

3.4 FORM OF GUARANTOR UNDERTAKING

This undertaking is entered into the [] day of [] 20[] by

[] (the "Guarantor") of [] in favour of

The Financial Services Authority Limited ("the FSA") whose registered office is at 25 The North Colonnade, Canary Wharf, London, E14 5HS.

WHEREAS:-

- (A) By a subordinated loan agreement (the "Loan Agreement") [made on]/[of even date] between [] (the "Lender"), [] (the "Borrower") and the FSA, the Lender made available to the Borrower a loan [facility] on the terms and conditions contained in the Loan Agreement.
- (B) By a guarantee (the "Guarantee") made [of even date] between the Guarantor and the Lender, the Guarantor guaranteed the obligations of the Borrower to the Lender under the Loan Agreement on the terms and conditions contained in the Guarantee.

IT IS HEREBY AGREED as follows:-

- 1 The Guarantor hereby undertakes to the FSA that all and any rights which the Guarantor may have against the Borrower in respect of the Guarantee (whether by subrogation or otherwise howsoever) shall be subordinated on the same terms and conditions (mutatis mutandis) set out in the Loan Agreement (as amended from time to time) and further undertakes and confirms that the Guarantor will be bound by the terms of the Loan Agreement as if the Guarantor were a party to it in place of the Lender.
- 2 This undertaking is governed by English law.

IN WITNESS whereof this deed has been executed by the Guarantor on the date first above written.

Executed as a Deed by
[]

Witness:.....

Witness's Name:

Witness's Address:

.....

3.5 Guidance Notes on Completion of Agreements

A GENERAL

Introduction

1. These Notes are designed to accompany the Approved Forms of Subordinated Loan Agreement, each of which is in four parts: the front page, the Variable Terms in Schedule 1, the Standard Terms in Schedule 2 and the signature page. The parties will need to set out details of themselves and the transaction in the Variable Terms and complete the signature page. The front page and the Standard Terms should remain unaltered.
2. All communications with the FSA regarding the proposed Agreement should in the first instance be via the firm's inspector.

ISD/Non-ISD

3. Firms are advised to ensure that the appropriate form of ISD (Chap.10)/non-ISD (Chap.3) subordinated loan agreement is used. This is, of course, dependent on the firm's authorisation categorisation. Should the firm's categorisation be changing from ISD to non-ISD (or vice versa), this should be discussed with the firm's inspector as it is likely that any subordinated loan agreement in place will have to be revised.

Preparation of the Agreement

4. (a) The form containing the Variable Terms may be completed or re-typed according to preference.
(b) Rather than re-type the Standard Terms (Schedule 2), firms should simply **photocopy Schedule 2 of the FSA precedent (or print it from the website) and include it as part of the original Agreement.**
5. [Deleted]

Financial Rule IPRU(INV) 3-63

6. Firms are referred to rule IPRU(INV) 3-63 on the use of subordinated loans, including restrictions on approved lenders, repayment provisions and gearing limits.

B NOTES ON VARIABLE TERMS

Dates

7. If the **Effective Date of the Agreement** is to be different from the Date of the Agreement, care should be taken to record this in paragraph 2. Where this is the case, the Effective Date will normally be expected to be later than the Date of the Agreement. If the Effective Date is to be a date prior to the date of the Agreement (for example because the loan was drawn down before the Agreement was put in place), the firm will be expected to provide a reasonable explanation to the FSA as to why it was not possible to document the loan more promptly.

Addresses

8. Paragraphs 4 and 6: The address given should be the firm's registered office or equivalent.

Partnerships

9. Paragraph 5: Where the Borrower is a partnership, insert "See Additional Terms, paragraph 10() below" and in paragraph 10 of Schedule 1, insert the names and addresses of each of the partners.

The Loan or Facility

10. Paragraph 7: Check that paragraph 2 of the Standard Terms accurately reflects the intentions of the parties.
11. Suggested wording for a loan is:
"This is an agreement for the Loan of £[]."

12. Suggested wording for a facility is:

"This is an agreement for a Facility under which the Lender is committed to make Advances in pounds sterling to the Borrower up to a maximum amount of £[] until the last available date of the Facility being [.....(date)].

The terms (if any) agreed between the parties on the mechanics of drawdown are as follows - ". *

* For example, the parties may wish to provide that:

“Advances may be drawdown in integral multiples of £100,000.”.

Interest

13. Paragraph 8: the FSA will be concerned if an excessive rate of interest compared with the market rate is charged. Broadly speaking a rate of interest will be regarded by the FSA as excessive if it is not a commercial one. Compound interest is not acceptable.

Repayment

14. Irrespective of the form of agreement being used, the specified notice period runs from the date of drawdown and, therefore, where a loan is in the form of a facility, each advance must be for a minimum of the required period.
15. Repayment clauses have given rise to confusion in the past. Sample wordings are set out below.
16. Under rule IPRU(INV) 3-63(5) (which is only relevant in relation to non-ISD firms), an amount repayable within three months of the effective date of the loan or advance is only acceptable as an eligible capital substitute in the absence of a waiver. A notice period of less than three months will accordingly require a waiver which will not normally be given. In many cases the most convenient approach is to provide for repayment on the expiry of three months written notice, such notice to be given to the FSA as well as to the other party to the agreement.
17. Paragraph 9: Examples of suggested wordings for either a fixed repayment date or repayment on notice for a non-ISD form are as follows:
- (a) "The Borrower shall repay [the Loan/each Advance made to it] on the date which falls three months after the date of drawdown of the [Loan/relevant Advance]."
 - (b) "The Borrower shall repay [the Loan/each Advance made to it] three months after the date on which:
 - (a) the Borrower gives written notice to the Lender and to the FSA; or
 - (b) the Lender gives written notice to the Borrower and to the FSA."

Note: either (a) or (b) above by itself is sufficient.

- (c) "[The Loan / Each Advance made to the Borrower] shall be repayable on the date specified by notice in writing given by the Lender to the Borrower and to the FSA or notice in writing given by the Borrower to the Lender and to the FSA, in either case that date being not less than three months after the date on which the notice is given."

Additional terms

18. Paragraph 10: Additional terms may be agreed between the borrower and lender such as those relating to -

- representations and warranties
- provision of financial and other information
- covenants
- costs and expenses
- taxes and increased costs
- mechanics of payment
- notices
- termination provisions.

However, they should not be inconsistent with the Agreement or the FSA rules. For example, any terms dealing with additional payments by the borrower (eg to compensate for taxes or increased costs) should be subject to the FSA's prior written consent. Covenants and additional representations and warranties should not be inconsistent with the existing representations and warranties in paragraphs 6 and 7 of the Standard Terms. Similarly, any notices clause should take into account paragraph 14 of the Standard Terms (notices to the FSA of no effect until receipt confirmed). Any inconsistency between the Variable Terms and the Standard Terms is resolved in favour of the Standard Terms (paragraph 11 of the Standard Terms).

The lender and borrower should note that the action which can be taken by the lender in response to any breach of representation, warranty or covenant by the borrower is considerably constrained by paragraphs 4 and 5 of the Standard Terms. Therefore the value to the lender of including additional representations, warranties or covenants is very limited.

19. See also note 9 above for the situation where the borrower is a partnership and notes 24 -25 below for additional terms relating to law and jurisdiction.

Law and jurisdiction

20. If the borrower or lender is resident in another jurisdiction and does not have a branch office within the United Kingdom, paragraph 11 of the Variable Terms should be completed.
21. The borrower should not be appointed agent for service of process on the lender in case a dispute arises between them.

C NOTES ON STANDARD TERMS

Representations and undertakings

22. Paragraphs 6(f) and 7(f): The guarantor or other provider of security must waive its right of subrogation against the borrower until all Senior Liabilities of the borrower have been paid in full. A form of deed for this purpose is available from the FSA.
23. On the effect of other terms relating to the subordinated liabilities not contained in this Agreement, see also paragraph 12 of the Standard Terms.
24. Paragraphs 15 and 16: See Notes 24-25 above.

D SIGNATURE PAGE

Arrangements for execution post FSA approval

25. **Two identical original Agreements** (i.e. the front page, the two Schedules and the signature page, each copy stapled or otherwise bound together) should be prepared for signature. Firms and lenders may use any of the execution forms set out in Notes 34-35 below.

E DEEDS OF VARIATION/ DEEDS OF TERMINATION

26. Firms are advised to ensure that the appropriate standard form is used. These forms are available from the FSA on request.
27. The recitals to the deed should refer to the amount of the loan/ each advance and where applicable, briefly summarise the effect of any previous variation of the agreement and of variation of the original agreement which is currently proposed.
28. A variation or termination of a subordinated loan agreement can only be effected by the execution of a further deed. In particular, this means that the formalities for executing a deed (see note 34-36 below) must be observed for all deeds of variation or termination and that all parties to the original agreement must also be parties to the subsequent deed of variation or termination. Only the forms set out at Notes 35(1) and (2) or 36(2) below are appropriate for execution as a deed.
29. A deed of variation will be required where the parties wish to change the terms of a subordinated loan agreement eg. where the amount of the loan or advance is to be increased. A deed of termination is needed where the parties wish to bring to terminate an agreement that is in place before it would otherwise come to an end. This could occur, for example, where the firm wants to substitute a new lender. Please note that where a subordinated loan agreement is terminated in this way, all obligations and liabilities of the parties arising before the date of termination remain in effect.

F Execution

30. In the case of English companies, reference is made to sections 36 and 36A of the Companies Act 1985 under which a company may contract
- under its common seal
 - through any person acting under its authority, express or implied,

and a document signed by a director and the secretary of the company or by two directors and expressed to be executed by the company as a deed has the same effect as if executed under the common seal of the company.

31. Suggested wordings for English companies are:

(1) THE COMMON SEAL OF

[]
was hereunto affixed
in the presence of

.....
Director

.....
Director/secretary

OR

(2) EXECUTED as a deed by []
in the presence of -

Signature of witness

Name of witness

Address of witness
.....

33. In the case of overseas companies or partnerships, appropriate wording should be used. If necessary, firms should obtain legal advice from lawyers qualified in the relevant jurisdiction.

FORM OF APPROVED BANK BOND
"A"

1. This Bond is issued by [] of [] ("the Bank") for the benefit of [] ("the Firm").
2. The Bank hereby IRREVOCABLY AND UNCONDITIONALLY undertakes to the Firm that forthwith upon receipt of a notice of demand in the form referred to in paragraph 3 of this Bond it shall pay to the Firm the sum of £[] ("the Bonded Amount").
3. The notice of demand referred to in paragraph 2 of this Bond is a notice duly executed by The Financial Services Authority Limited ("the FSA") on behalf of the Firm (pursuant to the power of attorney executed contemporaneously herewith) which :-
 - (i) is deposited at any time during the currency of this Bond at the address of the Bank set out in paragraph 1 of this Bond (or such other address as may be notified by the Bank in writing to the FSA for this purpose from time to time);
 - (ii) demands payment in full of the Bonded Amount; and
 - (iii) certifies that the Firm is in default of its financial resources requirement as determined in accordance with the rules in IPRU(INV) 3 in the FSA handbook ("the Financial Rules") as in force at the relevant time. The Bank shall not be entitled to inquire into or require proof of the facts stated in the notice of demand which, as between the Bank, the FSA and the Firm, shall be conclusive.
4. The Bank shall have no recourse to the assets of the Firm in respect of the Bonded Amount and no other person shall have recourse to the assets of the Firm in respect of the Bonded Amount until payment in respect of all present and future sums, liabilities and obligations payable or owing by the Firm (whether actual or contingent, jointly or severally or otherwise howsoever) has been made in full to all other creditors.
5. The Bank may not terminate the Bond unless -
 - (i) the Firm will have financial resources equal to at least 120% of its financial resources requirement as determined in accordance with the Financial Rules of the FSA as in force at the relevant time immediately after termination of the Bond; or
 - (ii) the Bank is authorised by the FSA to terminate the Bond.
6. This Bond will not be terminated before the date specified in paragraph 8 below through any act or default of the Firm or otherwise.
7. This Bond shall not be affected by any change in:-
 - (i) the constitution of the Bank or the Firm; or
 - (ii) the provisions of the Financial Rules of the FSA.

8. This Bond shall remain valid from the date of its issue until [] [and the Bank[and the Firm] hereby irrevocably submit to the non exclusive jurisdiction of the English courts and irrevocably appoint [] as agents for the service of process in the said jurisdiction].*
9. This Bond shall be governed by and construed and take effect in all respects in accordance with English law.

EXECUTED as a deed this [] day of [] 20[].

THE COMMON SEAL of)
 [Bank])
 was hereunto affixed)
 in the presence of:-)

* Words in square brackets only necessary if the Bank or the Firm is incorporated outside the U.K.

POWER OF ATTORNEY

BY THIS POWER OF ATTORNEY given on the [] day of [] a company [incorporated in the United Kingdom] having its registered office at [] ("the Company") appoints The Financial Services Authority Limited ("the FSA") whose registered office is 25 The North Colonnade, Canary Wharf, London, E14 5HS to be the true and lawful attorney of the Company for the following purpose:-

By way of security for the obligation of the Company to maintain sufficient financial resources as required by the rules in IPRU(INV) 3 of the FSA handbook as in force from time to time to demand payment on behalf of the Company of the sums payable pursuant to the terms of the Approved Bank Bond (annexed hereto marked "A") in the manner prescribed by the terms of such Approved Bank Bond.

The Company declares the authority hereby conferred to be irrevocable as long as the Company shall remain authorised to conduct investment business in the United Kingdom by the FSA.

The authority hereby conferred may be exercised on behalf of the FSA by any one of its officers or employees duly authorised in that regard by a resolution of the FSA's Board or a duly authorised committee thereof.

This Power of Attorney shall be governed by and construed and take effect in all respects in accordance with English law.

IN WITNESS WHEREOF this deed has been duly executed by the Company and it is intended to be and is hereby delivered the day and year first above written.

THE COMMON SEAL of)
[Company])
was hereunto affixed)
in the presence of:-)

3.7 APPROVED FORM OF UNDERTAKING

THIS UNDERTAKING is entered into the [] day of [] 20[] BETWEEN:

- (1) [] of [] ("the Covenantor");
- (2) THE FINANCIAL SERVICES AUTHORITY LIMITED ("the FSA") whose registered office is 25 The North Colonnade, Canary Wharf, London, E14 5HS; and
- (3) [] of [] ("the Principal") [and [] of [], [] of [], and [] of []] the individual partners of the Principal as such partners and as individuals **]+].

WHEREAS:

- (A) The Principal is authorised to carry on one or more regulated activities in the United Kingdom (as defined under the Financial Services and Markets Act 2000) by the FSA.
- (B) The Principal is required pursuant to the Financial Rules to maintain a Financial Resources Requirement (and the FSA has agreed that such Financial Resources Requirement may in part be represented by one or more undertakings in the form hereof to the extent that any undertaking(s) will not exceed the excess of 30% of the Principal's Base Requirement over the value of any Approved Bank Bond.
- (C) The Principal has requested the Covenantor to give an undertaking to the FSA for the purposes of the Principal's Financial Resources Requirement which the Covenantor has agreed to do.

NOW IT IS HEREBY AGREED AND DECLARED as follows:

1. Definitions

In this Undertaking:

"Base Requirement" has the meaning given in the Financial Rules;

"Business Day" means a day on which The International Stock Exchange of the United Kingdom Limited is open for business;

"Excluded Liabilities" means Liabilities which are expressed to be and in the opinion of the Insolvency Officer of the Principal [or, where relevant, the Insolvency Officer of a Partner**], do, rank junior to the Subordinated Liabilities in the insolvency of the Principal;

"Financial Resources" has the meaning given in the Financial Rules;

"Financial Resources Requirement" has the meaning given in the Financial Rules;

"the Financial Rules" means the rules in IPRU(INV) 3 of the FSA handbook;

"Insolvency" means and includes liquidation, winding up, bankruptcy and sequestration, administration, rehabilitation and dissolution (whichever term may apply to the Principal) or the equivalent in any other jurisdiction to which the Principal may be subject;

"Insolvency Officer" means and includes any person duly appointed to administer and distribute assets of the Principal in the course of the Principal's insolvency;

"Liabilities" means all present and future sums, liabilities and obligations payable or owing by the Principal [or any Partner**] (whether actual or contingent, jointly or severally or otherwise howsoever);

["Partner" means an individual partner of the Principal**];

"Senior Liabilities" means all Liabilities except all Liabilities in respect of any sums paid to the Principal under the terms of this Undertaking and Excluded Liabilities;

"Subordinated Liabilities" means all Liabilities to the Covenantor in respect of repayment of any sums paid to the Principal under the terms of this Undertaking.

Any reference to any rules of the FSA is a reference to them as already amended and includes a reference to any revoked rules which may be remade with or without amendments, and to any future rules and/or amendments of them.

2. In consideration of the FSA agreeing to take this Undertaking into account for the purpose of determining compliance by the Principal with its Financial Resources Requirement the Covenantor with intent to bind its successors and assigns and any body corporate with which it may amalgamate or merge HEREBY UNDERTAKES with and to the FSA and the Principal that at any time after the occurrence of any Event of Default specified in paragraph 6 hereof ("Event of Default") and notwithstanding that any other Event of Default may have occurred prior thereto the Covenantor will on demand in writing made upon it by the FSA accompanied by a certificate of the FSA as referred to in paragraph 9 hereof ("the Certificate") pay to the Principal or as the case may be the FSA (as determined in accordance with paragraph 3 below) the sum of £[] ("the Specified Amount").
3. In the case of an Event of Default falling within any of sub-paragraphs (1)(a), (1)(b) or (1)(c) of paragraph 6 below the sum to be paid pursuant to paragraph 2 above shall be paid to the FSA to be used at its discretion for any lawful purpose of the FSA , and in the case of an Event of Default falling within sub-paragraph (1)(d) of paragraph 6 below the sum to be paid pursuant to paragraph 2 above shall be paid to the Principal.
4. The liability of the Covenantor hereunder shall not be affected or discharged and the Covenantor shall not be released from its obligations hereunder by any act, omission, matter or thing whatsoever whereby, if the Covenantor was treated as a surety, guarantor or cautioner for the Principal, its liability would or might have been so affected or discharged or it might have been so released.
5. the FSA may without notification to or the consent of the Covenantor and without affecting or discharging the Covenantor's liability hereunder or releasing the Covenantor from its obligations hereunder from time to time waive or omit or fail to exercise or delay exercising its rights hereunder in respect of any Event of Default and any such waiver, omission, failure or delay shall not prejudice or affect the FSA 's rights hereunder in respect of that Event of Default (except in the case of a waiver) or any other or further Event of Default (whether or not of the same kind).
6. (1) The following shall be Events of Default for the purposes hereof:
 - (a) the Principal is deemed to be insolvent (as determined in accordance with sub-paragraph (2) below);
 - (b) the Principal is unable or admits its inability to pay its debts as they fall due or makes a general assignment for the benefit of, or a compensation with, its creditors;

- (c) an encumbrancer takes possession or a receiver, judicial factor, or similar officer is appointed over all or any part of the undertaking or assets of the Principal;
- (d) the Principal shall in the bona fide opinion of the FSA have failed to maintain an excess of Financial Resources over its Financial Resources Requirement and in the bona fide opinion of the FSA shall not have remedied the same within seven days after being required by the FSA to restore the deficiency.

[(2) The Principal is deemed to become insolvent:

- (a) on the making of a winding-up order against it; or
- (b) on the passing of a resolution for a voluntary winding up in a case in which no statutory declaration has been made under Section 89 of the Insolvency Act 1986 or Article 534 of the Companies (Northern Ireland) Order 1986; or
- (c) on the holding of a creditors meeting summoned under Section 95 of that Act or Article 54 of that Order; or
- (d) on the appointment of an administrator for it under Section 9 of that Act; or
- (e) the occurrence of an event corresponding as nearly as may be to any of those mentioned in sub-paragraphs (a) to (d) above in any other jurisdiction to which the Principal may be subject.*]

[(2) The Principal is deemed to become insolvent:

- (a) in England and Wales on the making of a winding-up order against it under any provision of the Insolvency Act 1986 as applied by an order under Section 420 of that Act; or
- (b) in Scotland, on the making of an award of sequestration on the estate of the partnership; or
- (c) in Northern Ireland, on the making of an adjudication of bankruptcy against any one of the partners; or
- (d) elsewhere on the occurrence of an event corresponding as nearly as may be to any of those mentioned above in this sub-paragraph.**]

[(2) The Principal is deemed to become insolvent if:

- (a) in England and Wales, a bankruptcy order is made against him; or in Scotland, an award of sequestration is made on his estate; or
- (b) in Scotland, and award of sequestration is made on his estate; or
- (c) in Northern Ireland, an adjudication of bankruptcy is made against him; or
- (d) elsewhere than in the United Kingdom, there occurs in relation to him any event corresponding to those mentioned above in this paragraph. *
* *]

7. This Undertaking shall be a continuing undertaking and shall apply irrespective of, and shall not be affected or discharged by, any matter relating to the compliance at any time by the Principal with its Financial Resources Requirement and in particular (but without limitation) the fact (if such be the case) that the Principal at any time complies or is able to comply with the Financial Resources Requirement without making use of this Undertaking or taking the same into account for the purposes of its Financial Resources Requirement.
8. This Undertaking shall apply in relation to any Event of Default occurring at or before the close of business on the earliest (if any) to occur of the following dates ("the Termination Date"):
 - (a) if the Covenantor gives the FSA not less than six months' written notice of its desire to terminate this Undertaking with effect from the date (being a date falling on or after the second anniversary of the date hereof) specified therein, such specified date;
 - (b) if the FSA and the Covenantor agree in writing to terminate this Undertaking with effect from the date specified in such agreement, such specified date; and
 - (c) if this Undertaking shall cease with effect from any day to be eligible to represent (in whole or in part) the Financial Resources Requirement to be maintained by the Principal pursuant to the Financial Rules, the date falling two business days after such day:

provided that no demand may be made upon the Covenantor hereunder later than midnight on the thirtieth business day after the Termination Date.

9.
 - (a) In any demand proceedings or otherwise under this Undertaking the occurrence of any Event of Default shall be conclusively proved by a certificate signed by a duly authorised signatory of the FSA which shall specify the Event of Default which has occurred and to which the certificate relates and shall give brief particulars thereof.
 - (b) If the FSA requires the Principal to remedy a breach of its Financial Resources Requirement as referred to in paragraph 6(1)(d) hereof, it shall notify the Covenantor thereof as soon as reasonably practicable thereafter.
10. A demand shall be duly made upon the Covenantor hereunder if it is signed by a duly authorised signatory of the FSA (accompanied by evidence reasonably satisfactory to the Covenantor of the signatory's authority) and is addressed to the Covenantor at its registered office [principal place of business in the United Kingdom] and posted by first-class mail and (if it has not been received prior thereto) the Covenantor shall be taken to have received such demand forty-eight hours after it is posted.
11. (1) The rights of the Covenantor to repayment of any sums paid to the Principal or, as the case may be, reimbursement by the Principal of any sums paid to the FSA under the terms of this Undertaking are subordinated to the Senior Liabilities and accordingly repayment of any such sums is conditional upon:
 - (a) (if an order has not been made or an effective resolution passed for the insolvency of the Principal) the Principal being in compliance with its Financial Resources Requirement prevailing at the time of payment by the Principal, and accordingly no such amount which would otherwise fall due for payment shall be payable except to the extent that, subject to sub-paragraph (2) below, the Principal could make such payment and still be in compliance with such Financial Resources Requirement immediately thereafter;
 - (b) (if an order has been made or effective resolution passed for the insolvency of the Principal) [or if the Principal shall be

dissolved**] the Principal being solvent at the time of payment by the Principal, and accordingly no such amount which would otherwise fall due for payment shall be payable except to the extent that the Principal could make such payment and still be solvent immediately thereafter. For the purposes of this sub-paragraph, the Principal shall be solvent if it is able to pay its debts in full and in determining whether the Principal is solvent there shall be disregarded obligations which are not payable or capable of being established or determined in the insolvency of the Principal and the Excluded Liabilities.

- (2) No payment of the Subordinated Liabilities shall be made at any time pursuant to sub-paragraph (1)(a) above unless:
 - (a) the Principal has given to the FSA prior written notification that it proposes to make such payment; and
 - (b) the FSA has notified the Principal in writing that it consents to such proposed payment.

The Principal shall give or procure that there are given to the FSA such information and auditor's certificate in relation to such proposed payment as the FSA may require.

- (3) For the purposes of sub-paragraph (1)(b) above a report given at any relevant time as to the solvency of the Principal by its Insolvency Officer, in form and substance acceptable to the FSA, shall in the absence of proven error be treated and accepted by the FSA, the Covenantor and the Principal as correct and sufficient evidence thereof.
- (4) If the Covenantor shall receive from the Principal [or any Partner**] payment of any sum in respect of the Subordinated Liabilities when any of the terms and conditions referred to in sub-paragraphs (1) or (2) above is not satisfied the payment of such sum shall be void for all purposes and [such sums shall be received by the Covenantor upon trust to return the same to the Principal+++] [the Covenantor shall at any time thereafter be bound to return such sum to the Principal or, as the case may be, its Insolvency Officer+] (and any sums so returned shall then be treated for the purposes of the Principal's obligations hereunder as if they had not been paid by the Principal and its original payment shall be deemed not to have discharged any of the obligations of the Principal hereunder). A request to the Covenantor for return of any sum under the foregoing provisions of this sub-paragraph (4) shall be in writing and shall be made by or on behalf of the Principal or, as the case may be, its Insolvency Officer.

12. The Covenantor will not without the prior written consent of the FSA :

- (i) assign or purport to assign to any person the whole or any part of the Subordinated Liabilities;
- (ii) purport to retain or set off at any time any amount payable by it to the Principal [or any Partner* *] against any amount of the Subordinated Liabilities except to the extent that payment of such amount of the Subordinated Liabilities would be permitted at such time by this Undertaking; amend any document evidencing or providing for the Subordinated Liabilities;
- (iii) amend any document evidencing or providing for the Subordinated Liabilities;

- (iv) attempt to obtain repayment of any of the Subordinated Liabilities otherwise than in accordance with the terms of this Undertaking;
 - (v) take or omit to take any action whereby the subordination of the Subordinated Liabilities or any part thereof to the Senior Liabilities might be terminated, impaired or adversely affected;
 - (vi) take any security from any person for all or any part of the Subordinated Liabilities, and the Covenantor shall, upon obtaining security in breach of this Undertaking, hold the same [on trust for+++][as agent of and for the benefit of+] the Principal.
13. The Covenantor acknowledges that the FSA would seek to enforce any breach of the undertaking of the Covenantor contained in Clause 2 hereof by seeking an order for specific performance thereof and the Covenantor acknowledges that an order for specific performance would be the remedy appropriate to be granted to the FSA for such a breach.
14. This Undertaking forms the entire agreement as to the agreement of the Covenantor to provide an undertaking in relation to the Principal's Financial Resources Requirement. If there are any other terms relating thereto existing at the date hereof and not comprised in this Undertaking such terms shall be of no further force and effect. No variation of or amendment to this Undertaking shall be of any effect unless it is in writing subscribed by all the parties hereto. Any amendment to this Undertaking made or purported to be made without the consent of the FSA shall be void.
- [15. This Undertaking shall subsist in full force and effect notwithstanding any change which may take place from time to time in the constitution or title of the Principal by the retirement of the present partners or [either] [any] of them or the assumption of new partners or by a change of name it being provided that:
- (a) A retired partner shall continue to be liable for the payment of all sums due hereunder and implementation of all other obligations herein contained until such time as the Bank and the remaining partner[s] shall agree in writing to release a retired partner from such obligations; and
 - (b) In the event of a new partner being assumed as a partner of the Principal the other partners shall procure that said assumed partner shall become bound to the Covenantor as a party to these presents and shall execute such addendum hereto as the Covenantor and the FSA may consider necessary. **] +]
- [16. The Principal and the Partners hereby acknowledge to the Covenantor and the FSA that subject to the foregoing provisions of the Agreement they will be jointly and severally liable to the Covenantor for any sum paid by the Covenantor hereunder and that irrespective of whether such sum was paid by the Covenantor to the Principal or to the FSA . **] +]
17. This Undertaking is governed by [English law+++++] [the law of Scotland+] [Northern Irish law+++++] [, and for the benefit of the FSA solely the Covenantor irrevocably submits to the jurisdiction of the [English Courts+++++] [Court of Session, Scotland+] [Northern Irish Courts+++++] and appoints [] as agent for receipt of service of process in such courts. Such jurisdiction shall be non-exclusive except to the extent that such non-exclusivity prejudices the submission to such jurisdiction].

Notes:

- (1) To be executed by the Covenantor under seal - other parties to execute either under seal or under hand.
- (2) Words in brackets throughout this document marked with a single asterisk are for use where the Principal is a corporation, those marked with a double asterisk are for use where the Principal is a partnership, and those marked with a triple asterisk where the Principal is an individual.
- (3) Words in brackets marked with a single cross are for use where the agreement is governed by Scottish law, with two crosses where the agreement is governed by either Scottish or Northern Irish law, three crosses where it is governed by either English or Northern Irish law, four crosses where it is governed by Northern Irish law and five crosses where it is governed by English law. Thus, for instance, words marked ++* * would be for use where the Borrower is a partnership and the agreement is governed by either Scottish or Northern Irish law.
- (4) Words in brackets in paragraph 17 above only required where either the Covenantor or the Principal (or both) are not incorporated in any part of the United Kingdom.

5 Investment Management Firms (former IMRO Firms)

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5.2 Prescribed Approved Undertaking	12

PRESCRIBED SUBORDINATED LOAN AGREEMENT

THIS SUBORDINATED LOAN AGREEMENT is made the ____ day of ____ 20____ between:

- (1) [____] of [____] (“the Lender” which term includes its permitted successors and assigns);
- (2) [____] of [____] (“the Borrower” which term includes its permitted successors and assigns).

WHEREAS

- (A) The Borrower is [has applied to be] regulated by FSA.
- (B) The Borrower is required to maintain financial resources to meet the provisions of Chapter 5 of the Interim Prudential Sourcebook as they apply to the Borrower at any particular time.
- (C) The Lender has agreed to lend [has lent] to the Borrower an amount as set out herein upon and subject to the terms and conditions contained in this Agreement.

NOW IT IS HEREBY AGREED as follows:

1. Definitions In this Agreement:
 - “Business Day”
means a day on which banks are open for all banking business in London;
 - “FSA”
means the Financial Services Authority;
 - “Interest Amount”
in respect of an Interest Period means the amount of interest payable in respect of such Interest Period calculated by applying the Rate of Interest in respect of such Interest Period to the average amount (calculated on a daily basis) of the principal of the Loan (together with any interest due but unpaid) outstanding during such Interest Period and multiplying the resulting sum by a fraction of which the numerator is equal to the actual number of days in the Interest Period concerned and the denominator is equal to 365;

“Interest Payment Date”

means [] and [] in each year;

“Interest Period”

means the period starting on the day following an Interest Payment Date and ending on the next following Interest Payment Date provided that the First Interest Period shall commence on the date hereof and end on the next following Interest Payment Date;

“Interim Prudential Sourcebook”

means the Interim Prudential Sourcebook for Investment Businesses made by the FSA;

“LIBOR”

in respect of an Interest Period means the rate determined by such London clearing bank as the Lender and Borrower shall agree to be the arithmetic mean (rounded to the nearest 1/16 of one per cent) of the offered quotations for 6 months sterling deposits in the London inter bank market at 11.00am (London time) on the Business Day prior to the commencement of such Interest Period;

“Loan”

means the Principal Amount (as defined in Clause 2) together with interest accrued thereon as may be outstanding from time to time;

“Rate of Interest”

in respect of an Interest Period means an amount expressed as a percentage per annum equal to the sum of LIBOR in respect of such Interest Period (expressed as a percentage per annum) and [] per cent per annum;

“Senior Creditors”

means all such persons who are:

- (a) unsubordinated creditors of the Borrower; or
- (b) subordinated creditors of the Borrower other than those whose claims are expressed to rank and do rank, pari passu with or junior to the claims of the Lender hereunder.

Clause headings in this Agreement are inserted for ease of reference only and shall not affect the construction of this Agreement.

2. The Loan

(a) The Lender [hereby agrees to advance]/[has on [] advanced] to the Borrower by way of loan the principal amount of [] (the “Principal Amount”) upon and subject to the terms and conditions contained in this Agreement.

[(b) [Upon signature hereof]/[On []] the Lender shall pay, or procure the payment of, the Principal Amount to the Borrower in freely available funds at its account number [] with [] bank.]

3. Interest

(a) Subject to the provisions of Clause 7 of this Agreement:

- (i) the Borrower will until repayment of the Loan in full pay to the Lender interest on the Loan or on any part or parts thereof for the time being remaining due hereunder in accordance with a written notice given by the Lender to the Borrower;
- (ii) on each Interest Payment Date the Borrower shall pay to the Lender the Interest Amount in respect of the Interest Period ending on such Interest Payment Date;

provided that at no time during the continuance of this Agreement shall the Rate of Interest exceed an annual rate of 5 per cent above LIBOR.

		(b) No payment on account of interest shall be made at any time to the extent that such payment would cause the Borrower to be in breach of rule 5.2.1(1) of Chapter 5 of the Interim Prudential Sourcebook (or any equivalent Rule for the time being in force). Any amount of interest whose payment is deferred under this provision shall be paid when and to the extent that the Borrower would not be in breach of rule 5.2.1(1) of the Interim Prudential Sourcebook after such payment. [The Agreement may make provision for interest on interest.]
4.	Early Repayment	<p>Subject to the provisions of Clause 7 of this Agreement the Borrower may make an early repayment of the whole or any part of the Loan provided that:</p> <p>(a) the written consent of FSA to such repayment is first obtained by the Borrower;</p> <p>(b) the Borrower must give to the Lender not less than one Business Day's prior notice of its intention to make such repayment, specifying the amount thereof and the date on which it is to be made (such notice to be ineffective if the winding up of the Borrower commences before the date on which such notice expires); and</p> <p>(c) the Borrower shall simultaneously pay all interest accrued to the date of repayment.</p>
5.	Repayment of the Loan	<p>Subject to the provisions of Clause 7 of this Agreement the Loan shall be repayable upon the expiry of [] months' written notice given by the Lender to the Borrower provided that:</p> <p>(a) such notice shall expire on a day falling after [five] [two] years from the date of [drawdown] [hereof]; and</p> <p>(b) the prior written consent of FSA to the repayment has first been obtained by the Borrower and not withdrawn; but</p> <p>(c) such notice shall cease to have effect if the winding up of the Borrower commences before the date on which such notice expires.</p>
6.	Event of Default	<p>Subject to the provisions of Clauses 7 and 10 of this Agreement:</p> <p>(a) if default is made for a period of five Business Days or more in the payment of any of the principal amount of the Loan [or for a period of 15 Business Days or more in the payment of any of the interest due in respect of the Loan] the Lender may, after taking such preliminary steps or actions as may be necessary, institute proceedings to wind up the Borrower;</p>

(b) if an order is made or an effective resolution is passed for the winding up of the Borrower, the Loan shall forthwith become repayable.

7. Subordination

Notwithstanding the provisions of Clauses 4, 5 and 6 of this Agreement, the rights of the Lender in respect of the Loan are subordinated in all respects to the rights of Senior Creditors in respect of amounts outstanding to them payable by the Borrower ("Senior Liabilities") and accordingly payment of any amount (whether in respect of principal, interest or otherwise and whether by way of repayment or prepayment) of the Loan shall be in all respects conditional upon compliance with the provisions below:

(a) The written consent of FSA to such payment is first obtained by the Borrower.

(b) (i) If at any time or from time to time an order has been made or an effective resolution passed for the winding up of the Borrower, then any payment of any amount (whether in respect of principal, interest or otherwise and whether by way of repayment or prepayment) of the Loan which under any other Clause of this Agreement would fall due for payment whilst the Borrower was insolvent or in insolvent liquidation will not fall so due, and instead such payment will become due for payment only if and when and to the extent that the Borrower could make such payment in whole or in part and still be solvent (whether or not it was in liquidation) thereafter. [Interest pursuant to Clause 3 hereof will continue to accrue on each and every such payment which is suspended under this Clause. Any payment suspended under this Clause but ultimately made will be made according to the amount of principal or interest (as the case may be) due to the Lender and in the event of both principal and interest being so suspended, payment will be made on account of principal before any payment is made on account of interest, but such alteration in order of payment will not prejudice the right of the Lender (which the Borrower acknowledges and confirms) to receive, subject to this Clause 7(b)(i) the full amount to which it would have been entitled if monies from time to time available for payment had been applied instead on account of interest before principal].

(ii) For the purposes of Clause 7(a) and (b) the Borrower may, and will whenever requested by the Lender whilst any payment remains suspended, procure a report or opinion by its auditors or (if it is in liquidation) by its liquidator as to whether or not the Borrower would be solvent at any time in any circumstances or whether or to what extent any payment in respect of the Loan could be made without infringing the provisions of this Sub-Clause and in the absence of proven error such report or opinion shall be treated and accepted by the Borrower and the Lender as correct and sufficient evidence of such fact.

(iii) Nothing in this Clause shall prevent the Lender from presenting or supporting any petition to wind up the Borrower, and the Borrower shall not put forward or rely on the provisions of this Clause as a ground for opposing any petition presented or supported by the Lender.

8. Payments

Subject to the provisions of Clause 7 of this Agreement:

- (a) all payments to be made by the Borrower hereunder shall be made in immediately available funds before [] on the date on which payment is due in such manner as the Lender may from time to time direct;
- (b) if any sum becomes due for payment pursuant to this Agreement on a day which is not a Business Day, such payment shall be made on the next succeeding Business Day and interest shall be adjusted accordingly;
- (c) all sums payable by the Borrower hereunder shall be paid in full without set off or counter claim and free and clear of and without deduction or withholding for or on account of any present or future taxes, duties or other charges. If any payment shall be subject to any such tax or if the Borrower shall be required by law to make any such deduction or withholding, the Borrower will pay such tax, will ensure that such payment, deduction or withholding, will not exceed the minimum legal liability therefore and will simultaneously pay to the Lender such additional amounts as will result in the Lender receiving a net amount equal to the full amount which the Lender would have received had no such payment, deduction or withholding been required.

9.	Regulatory Consent	<p>The Lender will not without the prior written consent of FSA:</p> <ul style="list-style-type: none"> (a) assign or purport to assign to any person this Agreement or the whole or any part of its rights against the Borrower in respect of the Loan; (b) purport to retain or set off at any time any amount of the Loan against any amount otherwise payable by it to the Borrower except to the extent that payment of such amount of the Loan would be permitted at such time by this Agreement; (c) amend or waive or concur in amending or waiving the terms of this Agreement; (d) attempt to obtain repayment of the whole or any part of the Loan otherwise than in accordance with the terms of this Agreement; (e) take or omit to take any action whereby the subordination of the Loan or any part thereof as provided for in Clause 7 of this Agreement might be terminated, impaired or adversely affected; or (f) take any security from any person for all or any part of the Loan and so that the Lender shall, upon obtaining security in breach of this Clause, hold the same on trust for the Borrower.
10.	Sole Remedy	<p>The Lender shall not be entitled to any remedy against the Borrower in respect of any default by the Borrower in repayment or prepayment of the Loan, or to enforce any other term of this Agreement, other than to institute proceedings to wind up the Borrower, provided always that the Borrower shall not, by the institution of such proceedings, become or be obliged to pay any sums or sum sooner than the same would otherwise have been payable by it pursuant to this Agreement.</p>
11.	Trust	<p>Any amounts paid by the Borrower or received or recovered by the Lender or any security taken from any person in respect of the Loan in breach of the provisions of this Agreement and any distributions of any kind or character in respect of the Loan received or recovered by the Lender otherwise than in accordance with the provisions of this Agreement shall be held on trust by the Lender to return the same to the Borrower, or where applicable, the liquidator or other similar such officer.</p>

12.	Entire Agreement	The Borrower and the Lender acknowledge that this Agreement forms the entire agreement relating to the Loan. If there are any other terms relating to the Loan existing at the date hereof and not comprised in this Agreement such terms shall be of no further force and effect.
13.	Continuing Obligations	The obligations of the Borrower and Lender hereunder shall be continuing obligations and shall be and remain fully effective until the repayment of the Loan in full in accordance with the provisions of this Agreement.
14.	Governing Law	This Agreement shall be governed by and construed in accordance with the laws of England and each of the parties hereby irrevocably submits to the non-exclusive jurisdiction of the Courts of England and Wales, Scotland and Northern Ireland.
15.	Rights of the FSA	Although not a party to the agreement, the FSA may in its own right enforce a term of the agreement to the extent that it purports to confer upon the FSA a benefit.
16.	Notices	<p>Any notice of demand to be given or made hereunder may be delivered by hand or sent by first class registered or pre-paid post to the recipient at the address first above mentioned or such other address as it shall last notify to each of the other parties hereto. Such notice shall be deemed to have been received:</p> <p>(a) if delivered by hand, on the day of delivery;</p> <p>(b) if sent by first class registered or pre-paid post three days after the date of despatch (as to which the sender's certificate shall be conclusive).</p>
17.	Counterparts	<p>This Agreement may be executed in any number of counterparts and by the different parties hereto on separate counterparts, each of which when so executed and delivered shall be an original, but all the counterparts shall together constitute one and the same instrument.</p> <p>IN WITNESS whereof the parties hereto have executed this Agreement as a deed the day and date first above written.</p>

Notes for Prescribed Subordinated Loan Agreement

These notes accompany the *prescribed subordinated loan agreement* and are intended to assist those who are or propose to be regulated by FSA. These notes relate solely to the mechanical drafting aspects of the prescribed agreement.

These notes refer to the Clauses in the order in which they appear in the prescribed agreement.

1. Parties Complete the name, registered number and registered office of the Lender and the Borrower.
2. Loan The Specimen Agreement provides for two alternative ways of advancing the Loan:
 - (a) one advance on the date of the Agreement; or
 - (b) one advance at a date other than the date of the Agreement.Firms are requested to specify clearly the date of the advance.
3. Interest The maximum rate of interest is 5 per cent above LIBOR. However, if a fixed rate of interest is charged, the Interest Rate must not exceed 5 per cent above LIBOR on the date the Loan is first taken out.

If the Loan is to be free of interest:

 - (a) Clause 3 should be deleted and replaced by the words "The Loan shall be interest-free"; and
 - (b) the definitions of "Interest Amount", "Interest Payment Date", "Interest Period", LIBOR and "Rate of Interest" should be deleted and consequential changes should be made to Clauses 4(c), 6(a), 7(preamble), 7(b)(i), and 8(b) accordingly.
4. Repayment The specified date of repayment must not be less than two years after:
 - (a) the date of the Agreement; or
 - (b) where the principal amount was advanced after the date of the Agreement, the date the principal amount was advanced.

5.	Execution	The date of the Agreement is the date on which execution of the Agreement by all parties is completed. Execution must accord with the laws and regulations governing the execution of documents in the jurisdiction of the Firm's principal place of business (e.g. a company whose principal place of business is in the UK must observe the requirements of Section 130 of the Companies Act 1989).
6.	Number of copies of Agreements	Three copies of the Agreement should be executed by both the Lender and the Borrower and forwarded to FSA. FSA will retain one original Agreement and return the other two copies to the Firm.

PRESCRIBED QUALIFYING UNDERTAKING

THIS UNDERTAKING IS ENTERED INTO

THE DAY OF 20 BETWEEN

- (1) [] of [] (“the Bank” or “Holding Company”)
- (2) FINANCIAL SERVICES AUTHORITY whose registered office is at 25 The North Colonnade, Canary Wharf, London E14 5HS (“FSA”) and
- (3) [] of [] (“the Principal”)

WHEREAS

- (A) The Principal is regulated by FSA
- (B) The Principal is required to maintain financial resources to meet the provisions of Chapter 5 of the Interim Prudential Sourcebook as they apply to the Principal and FSA has agreed that the Financial Resources Requirement may in part be represented by one or more undertakings in the form hereof
- (C) The Principal has requested the Bank or Holding Company to give an undertaking to FSA for the purposes of the Principal’s Financial Resources Requirement which the Bank or Holding Company has agreed to do

NOW THESE PRESENT WITNESS and it is hereby agreed and declared as follows:

1. In this Undertaking:

“Business Day”

means a day on which the Bank or Holding Company is open for business;

“Excluded Liabilities”

means Liabilities which are expressed to be and in the opinion of the liquidator of the Principal, do, rank junior to the Subordinated Liabilities in such liquidation;

“Financial Resources Requirement”

means the amount of liquid capital which the Principal is, pursuant to the Rules, required to maintain at any particular time;

“Interim Prudential Sourcebook”

means the Interim Prudential Sourcebook for Investment Businesses made by the FSA;

“Liabilities”

means all present and future sums, liabilities and obligations payable or owing by the Principal (whether actual or contingent, jointly or severally or otherwise howsoever);

“Senior Liabilities”

means all Liabilities except all Liabilities in respect of any sums paid to the Principal under the terms of this Undertaking and Excluded Liabilities;

“Subordinated Liabilities”

means all Liabilities of the Principal to the Bank or Holding Company in respect of repayment of any sums paid to the Principal under the terms of this Undertaking;

“the Rules”

means the Rules of FSA from time to time;

the term “liquid capital”

has the meaning ascribed to it in the Rules;

any reference to an enactment is a reference to it as already amended and includes a reference to any repealed enactment which it may re-enact, with or without amendments, and to any future re-enactment and/or amendment of it.

2. (a) In consideration of FSA agreeing to take this Undertaking into account for the purpose of determining compliance by the Principal with its Financial Resources Requirement the Bank or Holding Company with intent to bind its successors and assigns and any body corporate with which it may amalgamate or merge HEREBY UNDERTAKES with and to FSA and the Principal that at any time after the occurrence of any Event of Default specified in paragraph 5 hereof (“Event of Default”) and notwithstanding that any other Event of Default may have occurred prior thereto the Bank or Holding Company will on demand in writing made upon it by FSA accompanied by a certificate of FSA as referred to in paragraph 8 hereof (“the Certificate”) pay to the Principal the sum of £[] (“the Specified Amount”).
- (b) The Bank or Holding Company shall pay the Specified Amount to such account of the Principal as FSA may specify.
3. The liability of the Bank or Holding Company hereunder shall not be affected or discharged and the Bank or Holding Company shall not be released from its obligations hereunder by any act, omission, matter or thing whatsoever whereby, if the Bank or Holding Company was treated as a surety or guarantor for the Principal, its liability would or might have been so affected or discharged or it might have been so released.
4. FSA may without notification to or the consent of the Bank or Holding Company and without affecting or discharging the Bank’s or the Holding Company’s liability hereunder or releasing the Bank or Holding Company from its obligations hereunder from time to time waive or omit or fail to exercise or delay exercising its rights hereunder in respect of any Event of Default and any such waiver, omission, failure or delay shall not prejudice or affect FSA’s rights hereunder in respect of that Event of Default (except in the case of a waiver) or any other or further Event of Default (whether or not of the same kind).

5. The following shall be Events of Default for the purposes hereof:
- (a) the Principal is deemed to be unable to pay its debts in accordance with Section 123 of the Insolvency Act 1986;
 - (b) the Principal is unable or admits its inability to pay its debts as they fall due or makes a general assignment for the benefit of, or a composition with, its creditors;
 - (c) an encumbrancer takes possession, or a receiver, administrator or similar officer is appointed, of all or any part of the undertaking or assets of the Principal;
 - (d) the Principal shall in the opinion of FSA be in breach of its Financial Resources Requirement and in the opinion of FSA shall not have remedied such breach within 5 Business Days after being required by FSA to restore the deficiency.
6. This Undertaking shall be a continuing undertaking and shall apply irrespective of, and shall not be affected or discharged by, any matter relating to the compliance at any time by the Principal with its Financial Resources Requirement and in particular (but without limitation) the fact (if such be the case) that the Principal at any time complies or is able to comply with the Financial Resources Requirement without making use of this Undertaking or taking the same into account for the purposes of its Financial Resources Requirement.
7. This Undertaking shall apply in relation to any Event of Default occurring at or before the close of business on the earliest (if any) to occur of the following dates ("the Termination Date"):
- (a) if the Bank or Holding Company gives FSA not less than six months' written notice of its desire to terminate this Undertaking with effect from the date (being a date falling on or after the second anniversary of the date hereof) specified therein, such specified date;
 - (b) if FSA and the Bank or Holding Company agree in writing to terminate this Undertaking with effect from the date specified in such agreement, such specified date; and
 - (c) if this Undertaking shall cease with effect from any day to be eligible to represent (in whole or in part) the Financial Resources Requirement to be maintained by the Principal pursuant to the Rules, the date falling two Business Days after such day.
- Provided that no demand may be made upon the Bank or Holding Company hereunder later than midnight on the thirtieth Business Day after the Termination Date.
8. (a) In any demand proceedings or otherwise under this Undertaking the occurrence of any Event of Default shall be conclusively proved by a certificate signed by a duly authorised signatory of FSA which shall specify the Event of Default which has occurred and to which the certificate relates and shall give brief particulars thereof.
- (b) If FSA requires the Principal to remedy a breach of its Financial Resources Requirement as referred to in paragraph 5(d) hereof, it shall notify the Bank or Holding Company thereof as soon as reasonably practicable thereafter.

9. A demand shall be duly made upon the Bank or Holding Company hereunder if it is signed by a duly authorised signatory of FSA (accompanied by evidence reasonably satisfactory to the Bank or Holding Company of the signatory's authority) and is addressed to the Bank or Holding Company at its registered office [principal place of business in the UK] and posted by first class mail and (if it has not been received prior thereto) the Bank or Holding Company shall be taken to have received such demand forty-eight hours after it is posted.
10. (a) The rights of the Bank or Holding Company to repayment of any sums paid to the Principal under the terms of this Undertaking are subordinated to the Senior Liabilities and accordingly repayment of any such sums is conditional upon:
- (i) (if an order has not been made or an effective resolution passed for the winding up of the Principal) the Principal being in compliance with its Financial Resources Requirement prevailing at the time of payment by the Principal and no such payment which would otherwise fall due will fall so due except to the extent that, subject to sub-paragraph (b) below, the Principal could make such payment and still be in compliance with such Financial Resources Requirement immediately thereafter;
 - (ii) (if an order has been made or effective resolution passed for the winding up of the Principal) the Principal being solvent at the time of payment by the Principal and accordingly no such payment which would otherwise fall due for payment will fall due except to the extent that the Principal could make such payment and still be solvent immediately thereafter. For the purposes of this sub-paragraph, the Principal shall be solvent if it is able to pay its debts in full and in determining whether the Principal is solvent for the purposes of this sub-paragraph there shall be disregarded obligations which are not payable or capable of being established or determined in the winding up of the Principal and the Excluded Liabilities.
- (b) No payment of the Subordinated Liabilities shall be made at any time pursuant to sub-paragraph (a)(i) above unless:
- (i) the Principal has given to FSA prior written notification that it proposes to make such payment; and
 - (ii) FSA has notified the Principal in writing that it consents to such proposed payment.
- The Principal shall give or procure that there are given to FSA such information and auditor's certificate in relation to such proposed payment as FSA may require.
- (c) For the purposes of sub-paragraph (a)(ii) above a report given at any relevant time as to the solvency of the Principal by its liquidator, in form and substance acceptable to FSA, shall in the absence of proven error be treated and accepted by FSA, the Bank or Holding Company and the Principal as correct and sufficient evidence thereof.

(d) If the Bank or Holding Company shall receive from the Principal payment of any sum in respect of the Subordinated Liabilities when any of the terms and conditions referred to in sub-paragraphs (a) or (b) above is not satisfied the payment of such sum shall be void for all purposes and such sums shall be received by the Bank or Holding Company upon trust to return the same to the Principal and the Bank or Holding Company shall at any time thereafter be bound to return such sum to the Principal or, as the case may be, its liquidator (and any sums so returned shall then be treated for the purposes of the Principal's obligations hereunder as if they had not been paid by the Principal and its original payment shall be deemed not to have discharged any of the obligations of the Principal hereunder). A request to the Bank or Holding Company for return of any sum under the foregoing provisions of this sub-paragraph (d) shall be in writing and shall be made by or on behalf of the Principal or, as the case may be, its liquidator.

11. The Bank or Holding Company will not without the prior written consent of FSA:

- (i) assign or purport to assign to any person the whole or any part of the Subordinated Liabilities;
- (ii) purport to retain or set-off at any time any amount payable by it to the Principal against any amount of the Subordinated Liabilities except to the extent that payment of such amount of the Subordinated Liabilities would be permitted at such time by this Undertaking;
- (iii) amend any document evidencing or providing for the Subordinated Liabilities;
- (iv) attempt to obtain repayment of any of the Subordinated Liabilities otherwise than in accordance with the terms of this Undertaking;
- (v) take or omit to take any action whereby the subordination of the Subordinated Liabilities or any part thereof to the Senior Liabilities might be terminated, impaired or adversely affected;
- (vi) take any security from any person for all or any part of the Subordinated Liabilities, and the Bank or Holding Company shall, upon obtaining security in breach of this undertaking, hold the same on trust for the Principal.

12. The Bank or Holding Company acknowledges that FSA would seek to enforce any breach of the Undertaking of the Bank or Holding Company contained in Clause 2 hereof by seeking an order for specific performance thereof and the Bank or Holding Company acknowledges that an order for specific performance would be the remedy appropriate to be granted to FSA for such a breach.

13. This Undertaking forms the entire Agreement as to the agreement of the Bank or Holding Company to provide an undertaking in relation to the Principal's Financial Resources Requirement. If there are any other terms relating thereto existing at the date hereof and not comprised in this Undertaking such terms shall be of no further force and effect. No variation of or amendment to this Undertaking shall be of any effect unless it is in writing subscribed by all the parties hereto. Any amendment to this Undertaking made or purported to be made without the consent of FSA shall be void.

- 14.** This Undertaking is governed by English law [and for the benefit of FSA solely the Bank or Holding Company irrevocably submits to the jurisdiction of the Courts of England and Wales, Scotland and Northern Ireland and appoints [] as agent for receipt of service of process in such courts. Such jurisdiction shall be non-exclusive except to the extent that such non-exclusivity prejudices the submission to such jurisdiction].
- (1) To be executed by the Bank or Holding Company under seal—other parties to execute either under seal or under hand.*
- (2) Words in brackets in 9 and 14 above are required only where either the Bank or Holding Company or the Principal (or both) are not incorporated in any part of the UK.*
- (3) Where the Principal is not a company, the provisions of the Undertaking shall (in agreement with FSA) be amended as appropriate to reflect the legal status of the Principal.*

10 Securities and Futures Firms which are Investment Firms (former SFA ISD Firms)

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10.1 Approved Form of Long-Term Subordinated Loan Agreement

A. Front Page

THIS AGREEMENT is made on the date set out in the Variable Terms (as set out in **Schedule 1** to this Agreement) and is to be effective on that date unless a different effective date is set out in those terms

BETWEEN -

- (1) **the Lender** (as defined in the Standard Terms set out in **Schedule 2** to this Agreement), and
- (2) **the Borrower** (as defined in the Standard Terms)

WHEREAS the Borrower wishes to use the Loan, or each Advance under the Facility (as those expressions are defined in the Standard Terms) in accordance with FSA rule IPRU(INV) 10-63 and has fully disclosed to the FSA the circumstances giving rise to the Loan or Facility and the effective Subordination of the Loan and each Advance.

IT IS AGREED THAT this Agreement shall comprise the Variable Terms set out in **Schedule 1** to this Agreement and the Standard Terms set out in **Schedule 2** to this Agreement.

This Agreement is executed by the parties the day and year indicated in the Variable Terms.

Schedule 1

B. Variable Terms

1. Date of Agreement	
2. Effective Date	
3. Lender	
4. Address of Lender	
5. Borrower	
6. Address of Borrower	

7. **The Loan or Facility**

With reference to paragraph 2 of the Standard Terms,

--

8. **Interest**

With reference to paragraph 3 of the Standard Terms, interest shall be calculated and paid as follows -

--

9. **Repayment**

With reference to paragraph 4(2) of the Standard Terms and subject always to paragraphs 4(3) (restrictions on repayment) and 5 (subordination) of the Standard Terms, the terms for repayment are -

[Empty rectangular box for repayment terms]

Notes to paragraph 9 -

1. The repayment date for the Loan must be one or more of -
 - a date not less than five years from the date of drawdown,
 - a date not less than five years from the Borrower giving notice in writing to the Lender and the FSA, or
 - a date not less than five years from the Lender giving notice in writing to the Borrower and the FSA.
2. Where this Agreement is for a loan facility each Advance must be treated separately and have a repayment date not less than five years from the date of drawdown, or be subject to not less than five years' notice or have and be subject to both.

10. **Additional terms**

With reference to paragraph 11 of the Standard Terms, the additional terms to this Agreement are -

[Empty rectangular box for additional terms]

11. Jurisdiction

With reference to paragraph 16 of the Standard Terms, the person(s) indicated below is (are) appointed as agents for service of process -

(a) by the Lender -

--

of

--

(b) by the Borrower -

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of

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Schedule 2

C. Standard Terms

Interpretation

1 (1) In this Agreement -

“Advance” means, where this Agreement is for a loan facility, an amount drawn or to be drawn down by the Borrower or otherwise made available by the Lender under this Agreement as that amount may be reduced from time to time by any repayment or prepayment permitted under this Agreement;

“Borrower” means the person identified as such in the Variable Terms and includes its permitted successors and assigns and, where the Borrower is a partnership, each Partner;

“Business Day” means any day except Saturday, Sunday or a bank or public holiday in England;

“Effective Date” means the date on which this Agreement is to take effect being the date of this Agreement unless otherwise stated in the Variable Terms;

“Excluded Liabilities” means Liabilities which are expressed to be and, in the opinion of the Insolvency Officer of the Borrower, do, rank junior to the Subordinated Liabilities in any Insolvency of the Borrower;

“Facility” means the loan facility referred to in paragraph 2(2);

“Financial Resources” has the meaning given in the Financial Rules;

“Financial Resources Requirement” has the meaning given it in the Financial Rules;

“Financial Rules” means the rules in IPRU(INV) 10 in the FSA handbook;

“Insolvency” means and includes liquidation, winding up, bankruptcy, sequestration, administration, rehabilitation and dissolution (whichever term may apply to the Borrower) or the equivalent in any other jurisdiction to which the Borrower may be subject;

“Insolvency Officer” means and includes any person duly appointed to administer and distribute assets of the Borrower in the course of the Borrower’s Insolvency;

- 1 (1) **“Lender”** means the person identified as such in the Variable Terms and includes its permitted successors and assigns;

“Liabilities” means all present and future sums, liabilities and obligations payable or owing by the Borrower (whether actual or contingent, jointly or severally or otherwise howsoever);

“Loan” means the indebtedness of the Borrower to the Lender referred to in paragraph 2(1) as that indebtedness may be reduced from time to time by any repayment or prepayment permitted under this Agreement;

“Partner” means, where the Borrower is a partnership, each and every partner of the Borrower as a partner and as an individual (see also paragraph 8);

“Senior Liabilities” means all Liabilities except the Subordinated Liabilities and Excluded Liabilities;

“Subordinated Liabilities” means all Liabilities to the Lender in respect of the Loan or each Advance made under this Agreement and all interest payable thereon.

“the FSA” means The Financial Services Authority Limited whose registered office is at 25 The North Colonnade, Canary Wharf, London, E14 5HS; and

- (2) Any reference to any rules of the FSA is a reference to them as in force from time to time.
- (3) Reference to any gender includes a reference to all other genders.
- (4) Reference to a paragraph is to a paragraph of these Standard Terms, unless otherwise indicated.

The Loan or Facility

- 2 (1) Where as indicated in the Variable Terms this Agreement is for a loan, the Borrower hereby acknowledges its indebtedness to the Lender in the sum mentioned in the Variable Terms as an unsecured loan upon and subject to the terms and conditions of this Agreement.
- (2) Where, as indicated in the Variable Terms this Agreement is for a loan facility -
- (a) the maximum aggregate principal amount of each Advance outstanding at any time under the Facility shall not exceed the maximum amount specified in the Variable Terms or such other amount as may be agreed between the Borrower and the Lender from time to time;
- (b) the Facility will be available until the last available date specified in the Variable Terms; and

- 2** (2) (c) any specific terms dealing with the mechanics of drawdown are contained in the Variable Terms.
- (3) The Lender and the Borrower undertake to provide the FSA, immediately upon request, with details in writing of all principal and interest in respect of the Loan or each Advance outstanding for the time being and all payments of any amount made in the period specified by the FSA in the request.

Interest

- 3** Subject to the provisions of paragraphs 4 and 5, until repayment of the Loan or each Advance in full, the Borrower will pay to the Lender interest on the Loan or each Advance (or on any part or parts of it or them for the time being outstanding under this Agreement) calculated and payable in the manner set out in the Variable Terms.

Repayment

- 4** (1) The provisions of this paragraph are subject in all respects to the provisions of paragraph 5(subordination).
- (2) The terms concerning repayment are set out in the Variable Terms but are subject to paragraph 4(3).
- (3) (a) Except where the FSA otherwise permits, no repayment or prepayment of the Loan or any Advance may be made, in whole or in part, before the relevant repayment date provided for in paragraph 9 of the Variable Terms.
- (b) At the request of the Borrower, the FSA may permit the early repayment or prepayment of the Loan or any Advance, in whole or in part, only where, immediately after such repayment or prepayment, the Borrower's Financial Resources would be greater than 100% of its Financial Resources Requirement.
- (c) Payments of interest at a rate not exceeding the rate provided for in paragraph 3 may be made without notice to or consent of the FSA, except that where -
- (i) immediately after payment, the Borrower's Financial Resources would be less than or equal to 120% of its Financial Resources Requirement; or
- (ii) before payment, the Insolvency of the Borrower commences,
- no such payment may be made without the prior written consent of the FSA.
- (4) If in respect of the Loan or any Advance default is made for a period of -
- (a) seven days or more in the payment of any principal due, or
- (b) 14 days or more in the payment of any interest due,

- 4 (4) the Lender may, at its discretion and after taking such preliminary steps or actions as may be necessary, enforce payment by instituting proceedings for the Insolvency of the Borrower after giving seven Business Day's prior written notice to the FSA of its intention to do so.
- (5) Subject to (6) below, the Lender may at its discretion, subject as provided in this Agreement, institute proceedings for the Insolvency of the Borrower to enforce any obligation, condition or provision binding on the Borrower under this Agreement (other than any obligation for the payment of principal moneys or interest in respect of the Loan or any Advance) PROVIDED THAT the Borrower shall not by virtue of the institution of any such proceedings for the Insolvency of the Borrower be obliged to pay any sum or sums sooner than the same would otherwise have been payable by it.
- (6) The Lender may only institute proceedings for the Insolvency of the Borrower to enforce the obligations referred to in (5) above if -
- (a) a default under those obligations is not remedied to the satisfaction of the Lender within 60 days after notice of such default has been given to the Borrower by the Lender requiring such default to be remedied;
 - (b) the Lender has taken all preliminary steps or actions required to be taken by it prior to the institution of such proceedings; and
 - (c) the Lender has given seven Business Days' prior written notice to the FSA of its intention to institute such proceedings.
- (7) No remedy against the Borrower other than as specifically provided by this paragraph 4 shall be available to the Lender whether for the recovery of amounts owing under this Agreement or in respect of any breach by the Borrower of any of its obligations under this Agreement.

Subordination

- 5 (1) Notwithstanding the provisions of paragraph 4, the rights of the Lender in respect of the Subordinated Liabilities are subordinated to the Senior Liabilities and accordingly payment of any amount (whether principal, interest or otherwise) of the Subordinated Liabilities is conditional upon -
- (a) (if an order has not been made or an effective resolution passed for the Insolvency of the Borrower and, being a partnership, the Borrower has not been dissolved) the Borrower being in compliance with not less than 120% of its Financial Resources Requirement immediately after payment by the Borrower and accordingly no such amount which would otherwise fall due for payment shall be payable except to the extent that -
 - (i) paragraph 4(3) has been complied with; and

- 5 (1) (a) (ii) the Borrower could make such payment and still be in compliance with such Financial Resources Requirement; and
- (b) the Borrower being “solvent” at the time of, and immediately after, the payment by the Borrower and accordingly no such amount which would otherwise fall due for payment shall be payable except to the extent that the Borrower could make such payment and still be “solvent”.
- (2) For the purposes of sub-paragraph (1)(b) above, the Borrower shall be “solvent” if it is able to pay its Liabilities (other than the Subordinated Liabilities) in full disregarding -
- (a) obligations which are not payable or capable of being established or determined in the Insolvency of the Borrower, and
- (b) the Excluded Liabilities.
- (3) Interest will continue to accrue at the rate specified pursuant to paragraph 3 on any payment which does not become payable under this paragraph 5.
- (4) For the purposes of sub-paragraph (1)(b) above, a report given at any relevant time as to the solvency of the Borrower by its Insolvency Officer, in form and substance acceptable to the FSA, shall in the absence of proven error be treated and accepted by the FSA, the Lender and the Borrower as correct and sufficient evidence of the Borrower’s solvency or Insolvency.
- (5) Subject to the provisions of sub-paragraphs (6), (7) and (8) below, if the Lender shall receive from the Borrower payment of any sum in respect of the Subordinated Liabilities -
- (a) when any of the terms and conditions referred to in sub-paragraph (1) above is not satisfied, or
- (b) where such payment is prohibited under paragraph 4(3),
- the payment of such sum shall be void for all purposes.
- (6) Any sum referred to in sub-paragraph (5) above shall be received by the Lender upon trust to return it to the Borrower.
- (7) Any sum so returned shall then be treated for the purposes of the Borrower’s obligations hereunder as if it had not been paid by the Borrower and its original payment shall be deemed not to have discharged any of the obligations of the Borrower hereunder.
- (8) A request to the Lender for return of any sum referred to in sub-paragraph (5) shall be in writing and shall be made by or on behalf of the Borrower or, as the case may be, its Insolvency Officer.

Representations and undertakings of Borrower

- 6** From and after the date of this Agreement (or the Effective Date if earlier), the Borrower shall not without the prior written consent of the FSA -
- (a) secure all or any part of the Subordinated Liabilities;
 - (b) redeem, purchase or otherwise acquire any of the Subordinated Liabilities;
 - (c) amend any document evidencing or providing for the Subordinated Liabilities;
 - (d) repay any of the Subordinated Liabilities otherwise than in accordance with the terms of this Agreement;
 - (e) take or omit to take any action whereby the subordination of the Subordinated Liabilities or any part thereof to the Senior Liabilities might be terminated, impaired or adversely affected; or
 - (f) arrange or permit any contract of suretyship (or similar agreement) relating to its liabilities under this Agreement to be entered into, and
- other than as disclosed in writing to the FSA, the Borrower represents that it has not done so before the date of this Agreement (or the Effective Date if earlier).

Representations and undertakings of Lender

- 7** From and after the date of this Agreement (or the Effective Date if earlier), the Lender shall not without the prior written consent of the FSA -
- (a) assign, transfer, dispose of or encumber the whole or any part of the Subordinated Liabilities or purport to do so in favour of any person;
 - (b) purport to retain or set off at any time any amount payable by it to the Borrower against any amount of the Subordinated Liabilities except to the extent that payment of such amount of the Subordinated Liabilities would be permitted at such time by this Agreement, and the Lender shall immediately pay an amount equal to any retention or set off in breach of this provision to the Borrower and such retention or set off shall be deemed not to have occurred;
 - (c) amend or waive the terms of any document evidencing or providing for the Subordinated Liabilities;
 - (d) attempt to obtain repayment of any of the Subordinated Liabilities otherwise than in accordance with the terms of this Agreement;
 - (e) take or omit to take any action whereby the subordination of the Subordinated Liabilities or any part of them to the Senior Liabilities might be terminated, impaired or adversely affected; or

- 7 (f) take or enforce any security, guarantee or indemnity from any person for all or any part of the Subordinated Liabilities, and the Lender shall, upon obtaining or enforcing any security, guarantee or indemnity notwithstanding this undertaking, hold the same (and any proceeds thereof) on trust for the Borrower, and

other than as disclosed in writing to the FSA, the Lender represents that it has not done so before the date of this Agreement (or the Effective Date if earlier).

Borrower being a partnership

- 8 Where the Borrower is a partnership -

- (a) this Agreement shall subsist in full force and effect notwithstanding any change which may take place from time to time in the constitution or title of the Borrower by the retirement of the present Partners or any of them or the assumption of new Partners or by a change of name PROVIDED THAT -

- (i) a retired Partner shall continue to be liable for the payment of all sums due under this Agreement and implementation of all other obligations in this Agreement until the Lender and the remaining Partner(s) shall agree in writing to release a retired Partner from those obligations and the FSA has agreed in writing to the release; and

- (ii) in the event of a new Partner being assumed as a partner of the Borrower the other Partners shall procure that said assumed Partner shall become bound to the Lender as a party to this Agreement and shall execute such addendum hereto as the Lender and the FSA may consider necessary;

- (b) the obligations and undertakings of the Borrower under this Agreement shall bind the Borrower and the Partners jointly and severally.

Partial invalidity

- 9 If any of the provisions of this Agreement is or becomes invalid, illegal or unenforceable under any law, the validity, legality and enforceability of the remaining provisions shall not in any way be affected or impaired.

The FSA and indemnity

- 10 The FSA shall not, by virtue of having rights under this Agreement, be taken to be a trustee or other fiduciary for, or have any obligations to, any person to whom some or all of the Senior Liabilities are owed. Each of the Lender and Borrower shall on demand indemnify the FSA against all claims, losses, costs, expenses and other liabilities made against or incurred by the FSA as a consequence of it having rights, or taking action under this Agreement.

Additional terms

- 11** Any additional terms agreed between the parties are set out in the Variable Terms provided that, if there is any inconsistency between the Variable Terms and the Standard Terms, the Standard Terms shall prevail.

Entire agreement

- 12** This Agreement forms the entire agreement as to the Subordinated Liabilities. If there are any other terms relating to the Subordinated Liabilities existing at the date hereof and not comprised in this Agreement such terms shall be of no further force and effect.

Amendments

- 13** Any amendments to this Agreement must be made by the prescribed Deed of Variation and any amendments made or purported to be made without the consent of the FSA shall be void. For the avoidance of doubt, nothing in this paragraph requires the FSA to be a party to this Agreement.

Notices to the FSA

- 14** A notice given to the FSA under this Agreement shall have no effect, and time shall not start to run in connection with that notice, until the FSA has given to the sender written confirmation of its receipt.

Law

- 15** This Agreement is governed by English law.

Jurisdiction

- 16** For the benefit of the FSA solely, each of the Borrower and the Lender irrevocably submits to the jurisdiction of the English Courts and, to the extent that it does not have a place of business within the jurisdiction, appoints the process agent specified in the Variable Terms as agent for receipt of service of process in such courts. Such jurisdiction shall be non-exclusive except to the extent that non-exclusivity prejudices the submission to the jurisdiction.

Rights of the FSA

- 17** Although not a party to the Agreement, the FSA may in its own right enforce a term of the Agreement to the extent that it purports to confer upon the FSA a benefit.

10.2 Approved Form of Short-Term Subordinated Loan Agreement

A. Front Page

THIS AGREEMENT is made on the date set out in the Variable Terms (as set out in **Schedule 1** to this Agreement) and is to be effective on that date unless a different effective date is set out in those terms

BETWEEN -

- (1) **the Lender** (as defined in the Standard Terms set out in **Schedule 2** to this Agreement), and
- (2) **the Borrower** (as defined in the Standard Terms),

WHEREAS the Borrower wishes to use the Loan, or each Advance under the Facility (as those expressions are defined in the Standard Terms) in accordance with FSA rule IPRU(INV) 10-63 and has fully disclosed to the FSA the circumstances giving rise to the Loan or Facility and the effective subordination of the Loan and each Advance.

IT IS AGREED THAT this Agreement shall comprise the Variable Terms set out in **Schedule 1** to this Agreement and the Standard Terms set out in **Schedule 2** to this Agreement.

This Agreement is executed by the parties the day and year indicated in the Variable Terms.

Schedule 1

B. Variable Terms

1. Date of Agreement	
2. Effective Date	
3. Lender	
4. Address of Lender	
5. Borrower	
6. Address of Borrower	

7. **The Loan or Facility**

With reference to paragraph 2 of the Standard Terms,

--

8. **Interest**

With reference to paragraph 3 of the Standard Terms, interest shall be calculated and paid as follows -

--

9. **Repayment**

With reference to paragraph 4(2) of the Standard Terms and subject always to paragraphs 4(3) (restrictions on repayment) and 5 (subordination) of the Standard Terms, the terms for repayment are -

--	--

Notes to paragraph 9.

1. The repayment date for the Loan must be one or more of -
 - a date not less than two years from the date of drawdown,
 - a date not less than two years from the Lender giving notice in writing to the Borrower and the FSA, or
 - a date not less than two years from the Borrower giving notice in writing to the Lender and the FSA.
2. Where the Agreement is for a loan facility each Advance must be treated separately and have a repayment date not less than two years from the date of drawdown, or be subject to not less than two years' notice or have and be subject to both.

10. **Additional terms**

With reference to paragraph 11 of the Standard Terms, the additional terms to this Agreement are -

[Empty rectangular box for listing additional terms]

11. Jurisdiction

With reference to paragraph 16 of the Standard Terms, the person(s) indicated below is (are) appointed as agents for service of process -

(a) by the Lender -

--

of

--

(b) by the Borrower -

--

of

--

Schedule 2

C. Standard Terms

Interpretation

1 (1) In this Agreement -

“Advance” means, where this Agreement is for a loan facility, an amount drawn or to be drawn down by the Borrower or otherwise made available by the Lender under this Agreement as that amount may be reduced from time to time by any repayment or prepayment permitted under this Agreement;

“Borrower” means the person identified as such in the Variable Terms and includes its permitted successors and assigns and, where the Borrower is a partnership, each Partner;

“Business Day” means any day except Saturday, Sunday or a bank or public holiday in England;

“Effective Date” means the date on which this Agreement is to take effect being the date of this Agreement unless otherwise stated in the Variable Terms;

“Excluded Liabilities” means Liabilities which are expressed to be and, in the opinion of the Insolvency Officer of the Borrower, do, rank junior to the Subordinated Liabilities in any Insolvency of the Borrower;

“Facility” means the loan facility referred to in paragraph 2(2);

“Financial Resources” has the meaning given in the Financial Rules;

“Financial Resources Requirement” has the meaning given it in the Financial Rules;

“Financial Rules” means the rules in IPRU(INV) 10 of the FSA handbook;

“Insolvency” means and includes liquidation, winding up, bankruptcy, sequestration, administration, rehabilitation and dissolution (whichever term may apply to the Borrower) or the equivalent in any other jurisdiction to which the Borrower may be subject;

“Insolvency Officer” means and includes any person duly appointed to administer and distribute assets of the Borrower in the course of the Borrower’s Insolvency;

- 1 (1) **“Lender”** means the person identified as such in the Variable Terms and includes its permitted successors and assigns;

“Liabilities” means all present and future sums, liabilities and obligations payable or owing by the Borrower (whether actual or contingent, jointly or severally or otherwise howsoever);

“Loan” means the indebtedness of the Borrower to the Lender referred to in paragraph 2(1) as that indebtedness may be reduced from time to time by any repayment or prepayment permitted under this Agreement;

“Partner” means, where the Borrower is a partnership, each and every partner of the Borrower as a partner and as an individual (see also paragraph 8);

“Senior Liabilities” means all Liabilities except the Subordinated Liabilities and Excluded Liabilities;

“Subordinated Liabilities” means all Liabilities to the Lender in respect of the Loan or each Advance made under this Agreement and all interest payable thereon.

“the FSA” means The Financial Services Authority Limited whose registered office is at 25 The North Colonnade, Canary Wharf, London, E14 5HS; and

- (2) Any reference to any rules of the FSA is a reference to them as in force from time to time.
- (3) Reference to any gender includes a reference to all other genders.
- (4) Reference to a paragraph is to a paragraph of these Standard Terms, unless otherwise indicated.

The Loan or Facility

- 2 (1) Where as indicated in the Variable Terms this Agreement is for a loan, the Borrower hereby acknowledges its indebtedness to the Lender in the sum mentioned in the Variable Terms as an unsecured loan upon and subject to the terms and conditions of this Agreement.
- (2) Where, as indicated in the Variable Terms this Agreement is for a loan facility -
- (a) the maximum aggregate principal amount of each Advance outstanding at any time under the Facility shall not exceed the maximum amount specified in the Variable Terms or such other amount as may be agreed between the Borrower and the Lender from time to time;
- (b) the Facility will be available until the last available date specified in the Variable Terms; and

- 2** (2) (c) any specific terms dealing with the mechanics of drawdown are contained in the Variable Terms.
- (3) The Lender and the Borrower undertake to provide the FSA, immediately upon request, with details in writing of all principal and interest in respect of the Loan or each Advance outstanding for the time being and all payments of any amount made in the period specified by the FSA in the request.

Interest

- 3** Subject to the provisions of paragraphs 4 and 5, until repayment of the Loan or each Advance in full, the Borrower will pay to the Lender interest on the Loan or each Advance (or on any part or parts of it or them for the time being outstanding under this Agreement) calculated and payable in the manner set out in the Variable Terms.

Repayment

- 4** (1) The provisions of this paragraph are subject in all respects to the provisions of paragraph 5(subordination).
- (2) The terms concerning repayment are set out in the Variable Terms but are subject to paragraph 4(3).
- (3) (a) Except where the FSA otherwise permits, no repayment, or prepayment of the Loan or any Advance may be made, in whole or in part, before the relevant repayment date provided for in paragraph 9 of the Variable Terms.
- (b) the FSA may permit the early repayment or prepayment of the Loan or any Advance, in whole or in part, only where, immediately after such repayment or prepayment, the Borrower's Financial Resources would be greater than 100% of its Financial Resources Requirement.
- (c) Payments of interest at a rate not exceeding the rate provided for in paragraph 3 may be made without notice to or consent of the FSA, except that where -
- (i) immediately after payment, the Borrower's Financial Resources would be less than or equal to 120% of its Financial Resources Requirement; or
- (ii) before payment, the Insolvency of the Borrower commences,
- no such payment may be made without the prior written consent of the FSA.
- (4) If in respect of the Loan or any Advance default is made for a period of -
- (a) seven days or more in the payment of any principal due, or
- (b) 14 days or more in the payment of any interest due,

- 4 (4) the Lender may, at its discretion and after taking such preliminary steps or actions as may be necessary, enforce payment by instituting proceedings for the Insolvency of the Borrower after giving seven Business Day's prior written notice to the FSA of its intention to do so.
- (5) Subject to (6) below, the Lender may at its discretion, subject as provided in this Agreement, institute proceedings for the Insolvency of the Borrower to enforce any obligation, condition or provision binding on the Borrower under this Agreement (other than any obligation for the payment of principal moneys or interest in respect of the Loan or any Advance) PROVIDED THAT the Borrower shall not by virtue of the institution of any such proceedings for the Insolvency of the Borrower be obliged to pay any sum or sums sooner than the same would otherwise have been payable by it.
- (6) The Lender may only institute proceedings for the Insolvency of the Borrower to enforce the obligations referred to in (5) above if -
- (a) a default under those obligations is not remedied to the satisfaction of the Lender within 60 days after notice of such default has been given to the Borrower by the Lender requiring such default to be remedied;
 - (b) the Lender has taken all preliminary steps or actions required to be taken by it prior to the institution of such proceedings; and
 - (c) the Lender has given seven Business Days' prior written notice to the FSA of its intention to institute such proceedings.
- (7) No remedy against the Borrower other than as specifically provided by this paragraph 4 shall be available to the Lender whether for the recovery of amounts owing under this Agreement or in respect of any breach by the Borrower of any of its obligations under this Agreement.

Subordination

- 5 (1) Notwithstanding the provisions of paragraph 4, the rights of the Lender in respect of the Subordinated Liabilities are subordinated to the Senior Liabilities and accordingly payment of any amount (whether principal, interest or otherwise) of the Subordinated Liabilities is conditional upon -
- (a) (if an order has not been made or an effective resolution passed for the Insolvency of the Borrower and, being a partnership, the Borrower has not been dissolved) the Borrower being in compliance with not less than 120% of its Financial Resources Requirement immediately after payment by the Borrower and accordingly no such amount which would otherwise fall due for payment shall be payable except to the extent that -
 - (i) paragraph 4(3) has been complied with; and

- 5 (1) (a) (ii) the Borrower could make such payment and still be in compliance with such Financial Resources Requirement; and
- (b) the Borrower being “solvent” at the time of, and immediately after, the payment by the Borrower and accordingly no such amount which would otherwise fall due for payment shall be payable except to the extent that the Borrower could make such payment and still be “solvent”.
- (2) For the purposes of sub-paragraph (1)(b) above, the Borrower shall be “solvent” if it is able to pay its Liabilities (other than the Subordinated Liabilities) in full disregarding -
- (a) obligations which are not payable or capable of being established or determined in the Insolvency of the Borrower, and
- (b) the Excluded Liabilities.
- (3) Interest will continue to accrue at the rate specified pursuant to paragraph 3 on any payment which does not become payable under this paragraph 5.
- (4) For the purposes of sub-paragraph (1)(b) above, a report given at any relevant time as to the solvency of the Borrower by its Insolvency Officer, in form and substance acceptable to the FSA, shall in the absence of proven error be treated and accepted by the FSA, the Lender and the Borrower as correct and sufficient evidence of the Borrower’s solvency or Insolvency.
- (5) Subject to the provisions of sub-paragraphs (6), (7) and (8) below, if the Lender shall receive from the Borrower payment of any sum in respect of the Subordinated Liabilities -
- (a) when any of the terms and conditions referred to in sub-paragraph (1) above is not satisfied, or
- (b) where such payment is prohibited under paragraph 4(3),
- the payment of such sum shall be void for all purposes.
- (6) Any sum referred to in sub-paragraph (5) above shall be received by the Lender upon trust to return it to the Borrower.
- (7) Any sum so returned shall then be treated for the purposes of the Borrower’s obligations hereunder as if it had not been paid by the Borrower and its original payment shall be deemed not to have discharged any of the obligations of the Borrower hereunder.
- (8) A request to the Lender for return of any sum referred to in sub-paragraph (5) shall be in writing and shall be made by or on behalf of the Borrower or, as the case may be, its Insolvency Officer.

Representations and undertakings of Borrower

- 6** From and after the date of this Agreement (or the Effective Date if earlier), the Borrower shall not without the prior written consent of the FSA -
- (a) secure all or any part of the Subordinated Liabilities;
 - (b) redeem, purchase or otherwise acquire any of the Subordinated Liabilities;
 - (c) amend any document evidencing or providing for the Subordinated Liabilities;
 - (d) repay any of the Subordinated Liabilities otherwise than in accordance with the terms of this Agreement;
 - (e) take or omit to take any action whereby the subordination of the Subordinated Liabilities or any part thereof to the Senior Liabilities might be terminated, impaired or adversely affected; or
 - (f) arrange or permit any contract of suretyship (or similar agreement) relating to its liabilities under this Agreement to be entered into, and

other than as disclosed in writing to the FSA, the Borrower represents that it has not done so before the date of this Agreement (or the Effective Date if earlier).

Representations and undertakings of Lender

- 7** From and after the date of this Agreement (or the Effective Date if earlier), the Lender shall not without the prior written consent of the FSA -
- (a) assign, transfer, dispose of or encumber the whole or any part of the Subordinated Liabilities or purport to do so in favour of any person;
 - (b) purport to retain or set off at any time any amount payable by it to the Borrower against any amount of the Subordinated Liabilities except to the extent that payment of such amount of the Subordinated Liabilities would be permitted at such time by this Agreement, and the Lender shall immediately pay an amount equal to any retention or set off in breach of this provision to the Borrower and such retention or set off shall be deemed not to have occurred;
 - (c) amend or waive the terms of any document evidencing or providing for the Subordinated Liabilities;
 - (d) attempt to obtain repayment of any of the Subordinated Liabilities otherwise than in accordance with the terms of this Agreement;
 - (e) take or omit to take any action whereby the subordination of the Subordinated Liabilities or any part of them to the Senior Liabilities might be terminated, impaired or adversely affected; or

- 7 (f) take or enforce any security, guarantee or indemnity from any person for all or any part of the Subordinated Liabilities, and the Lender shall, upon obtaining or enforcing any security, guarantee or indemnity notwithstanding this undertaking, hold the same (and any proceeds thereof) on trust for the Borrower, and

other than as disclosed in writing to the FSA, the Lender represents that it has not done so before the date of this Agreement (or the Effective Date if earlier).

Borrower being a partnership

- 8 Where the Borrower is a partnership -

- (a) this Agreement shall subsist in full force and effect notwithstanding any change which may take place from time to time in the constitution or title of the Borrower by the retirement of the present Partners or any of them or the assumption of new Partners or by a change of name PROVIDED THAT -

- (i) a retired Partner shall continue to be liable for the payment of all sums due under this Agreement and implementation of all other obligations in this Agreement until the Lender and the remaining Partner(s) shall agree in writing to release a retired Partner from those obligations and the FSA has agreed in writing to the release; and

- (ii) in the event of a new Partner being assumed as a partner of the Borrower the other Partners shall procure that said assumed Partner shall become bound to the Lender as a party to this Agreement and shall execute such addendum hereto as the Lender and the FSA may consider necessary;

- (b) the obligations and undertakings of the Borrower under this Agreement shall bind the Borrower and the Partners jointly and severally.

Partial invalidity

- 9 If any of the provisions of this Agreement is or becomes invalid, illegal or unenforceable under any law, the validity, legality and enforceability of the remaining provisions shall not in any way be affected or impaired.

The FSA and indemnity

- 10 The FSA shall not, by virtue of having rights under this Agreement, be taken to be a trustee or other fiduciary for, or have any obligations to, any person to whom some or all of the Senior Liabilities are owed. Each of the Lender and Borrower shall on demand indemnify the FSA against all claims, losses, costs, expenses and other liabilities made against or incurred by the FSA as a consequence of it having rights, or taking action under this Agreement.

Additional terms

- 11** Any additional terms agreed between the parties are set out in the Variable Terms provided that, if there is any inconsistency between the Variable Terms and the Standard Terms, the Standard Terms shall prevail.

Entire agreement

- 12** This Agreement forms the entire agreement as to the Subordinated Liabilities. If there are any other terms relating to the Subordinated Liabilities existing at the date hereof and not comprised in this Agreement such terms shall be of no further force and effect.

Amendments

- 13** Any amendments to this Agreement must be made by the prescribed Deed of Variation and any amendments made or purported to be made without the consent of the FSA shall be void. For the avoidance of doubt, nothing in this paragraph requires the FSA to be a party to this Agreement.

Notices to the FSA

- 14** A notice given to the FSA under this Agreement shall have no effect, and time shall not start to run in connection with that notice, until the FSA has given to the sender written confirmation of its receipt.

Law

- 15** This Agreement is governed by English law.

Jurisdiction

- 16** For the benefit of the FSA solely, each of the Borrower and the Lender irrevocably submits to the jurisdiction of the English Courts and, to the extent that it does not have a place of business within the jurisdiction, appoints the process agent specified in the Variable Terms as agent for receipt of service of process in such courts. Such jurisdiction shall be non-exclusive except to the extent that non-exclusivity prejudices the submission to the jurisdiction.

Rights of the FSA

- 17** Although not a party to the Agreement, the FSA may in its own right enforce a term of the Agreement to the extent that it purports to confer upon the FSA a benefit.

10.3 FORM OF DEED OF TERMINATION

THIS DEED OF TERMINATION is made on the day of 20....

BETWEEN -

- (1) * [insert full name of Lender] (registered in [England] number *) whose registered office is at [*if an individual or partnership* of] * (“the **Lender**”).
- (2) * [insert full name of Borrower] (registered in [England] number *) whose registered office is at [*if an individual or partnership* of] * (“the **Borrower**”).
- (3) **The Financial Services Authority Limited** (registered in England number 1920623) whose registered office is at 25 The North Colonnade, Canary Wharf, London, E14 5HS (“**the FSA**”).

WHEREAS -

A subordinated loan agreement was entered in between the Lender (1); the Borrower (2); and the FSA (3) on [date] (“the Agreement”) pursuant to which the Lender agreed to make available to the Borrower a [Loan/Facility] of up to [£]. [insert brief details of any Variations] The parties to the Agreement now wish to terminate the Agreement.

IT IS AGREED THAT -

1. The Agreement shall be deemed terminated [in accordance with its terms] with effect from [the date of this Deed of Termination/insert relevant future date]. All obligations and liabilities arising before that date shall remain continuing.
2. This Deed is governed by English Law.

IN WITNESS WHEREOF this Deed has been executed by the parties and is intended to be and is hereby delivered on the date first above written.

Executed as a deed by [full name of Lender]

.....

Signed
Director

Signed
Director/Secretary

or

Signed as a deed by
[full names of individual partners of Lender]

(as such partners and as individuals)

Signed.....
Partner

Signed.....
Partner/Witness

or

Signed as a deed by [full name of Lender]
(if an individual)

Signed.....

in the presence of

Signed.....
Witness

Executed as a deed by [full name of Borrower]

.....

Signed
Director

Signed
Director/Secretary

or

Signed as a deed by [full names of individual
partners of Borrower]
(as such partners and as individuals)

Signed.....
Partner

Signed.....
Partner/Witness

or

Signed as a deed by [full name of Borrower]
(if an individual)

Signed.....

in the presence of

Signed.....
Witness

The Common Seal of THE FINANCIAL
SERVICES AUTHORITY LIMITED
was hereunto affixed in the
presence of

Signed
Authorised Signatory

Signed
Authorised Signatory

10.4 FORM OF DEED OF VARIATION

THIS DEED OF VARIATION is made on the day of 2.....

BETWEEN -

- (1) * [insert full name of Lender] (registered in [England] number *) whose registered office is at [if an individual or partnership of] * (“the **Lender**”);
- (2) * [insert full name of Borrower] (registered in [England] number *) whose registered office is at [if an individual or partnership of] * (“the **Borrower**”); and
- (3) **The Financial Services Authority Limited** (registered in England number 1920623) whose registered office is at 25 The North Colonnade, Canary Wharf, London, E14 5HS (“the **FSA**”).

WHEREAS -

A subordinated loan agreement was entered into between the Lender (1); the Borrower (2); and the FSA (3) on [date] 199 (“the Agreement”) pursuant to which the Lender agreed to make available to the Borrower a (Loan/Facility) of up to [£].

The parties to the Agreement now wish to vary the Agreement to [insert brief details].

IT IS AGREED THAT -

1. The Agreement shall be deemed varied [, in accordance with its terms,] from [the date of this Deed of Variation/insert relevant future date] so that the FSA is no longer a party to the Agreement. Any obligation owed to or by, and any requirement for any consent or permission to be given to or by, FSA shall be of no further effect. FSA is hereby released from each and every obligation owed by it under the Agreement. Although on the execution of this deed the FSA is no longer a party to the Agreement, it may in its own right enforce a term of the Agreement to the extent that it purports to confer upon the FSA a benefit.

[insert additional clauses/details of amended clauses].

to the extent that any term of the Agreement is inconsistent with their terms and conditions contained in the Approved Form, the terms and conditions in the Approved Form shall prevail (provided that for the purposes of this clause 1, in clauses 11 and 12 of the Approved Form, the expressions “Variable Terms” and “Agreement” shall be deemed to include references to the Agreement and this Deed.

2. All other terms and conditions of the Agreement remain unchanged.
3. This Deed is governed by English Law.

IN WITNESS WHEREOF this Deed has been executed by the parties and is intended to be and is hereby delivered on the date first above written.

Executed as a deed by [full name of Lender]

.....

Signed
Director

Signed
Director/Secretary

or

Signed as a deed by
[full names of individual partners of Lender]
(as such partners and as individuals)

Signed.....
Partner

Signed.....
Partner/Witness

or

Signed as a deed by [full name of Lender]
(if an individual)

Signed.....

in the presence of

Signed.....
Witness

Executed as a deed by [full name of Borrower]

.....

Signed
Director

Signed
Director/Secretary

or

Signed as a deed by [full names of individual

partners of Borrower]
(as such partners and as individuals)

Signed.....
Partner

Signed.....
Partner/Witness

or

Signed as a deed by [full name of Borrower]
(if an individual)

Signed.....

in the presence of

Signed.....
Witness

The Common Seal of THE FINANCIAL
SERVICES AUTHORITY LIMITED
was hereunto affixed in the
presence of

Signed
Authorised Signatory

Signed
Authorised Signatory

10.5 FORM OF GUARANTOR UNDERTAKING

This undertaking is entered into the [] day of [] 20[] by

[] (the "Guarantor") of [] in favour of

The Financial Services Authority Limited ("the FSA") whose registered office is at
25 The North Colonnade, Canary Wharf, London, E14 5HS.

WHEREAS:-

- (A) By a subordinated loan agreement (the "Loan Agreement") made [of even date] between [] (the "Lender"), [] (the "Borrower") and the FSA, the Lender made available to the Borrower a loan [facility] on the terms and conditions contained in the Loan Agreement.
- (B) By a guarantee (the "Guarantee") made [of even date] between the Guarantor and the Lender, the Guarantor guaranteed the obligations of the Borrower to the Lender under the Loan Agreement on the terms and conditions contained in the Guarantee.

IT IS HEREBY AGREED as follows:-

- 1 The Guarantor hereby undertakes to the FSA that all and any rights which the Guarantor may have against the Borrower in respect of the Guarantee (whether by subrogation or otherwise howsoever) shall be subordinated on the same terms and conditions (mutatis mutandis) set out in the Loan Agreement (as amended from time to time) and further undertakes and confirms that the Guarantor will be bound by the terms of the Loan Agreement as if the Guarantor were a party to it in place of the Lender.
- 2 This undertaking is governed by English law.

IN WITNESS whereof this deed has been executed by the Guarantor on the date first above written.

Executed as a Deed by
[]

Witness:.....

Witness's Name:

Witness's Address:

.....

10.6 Approved Form of Long-Term Subordinated Loan Agreement for the purposes of Consolidated Supervision

A. Front Page

THIS AGREEMENT is made on the date set out in the Variable Terms (as set out in **Schedule 1** to this Agreement) and is to be effective on that date unless a different effective date is set out in those terms

BETWEEN -

- (1) **the Lender** (as defined in the Standard Terms set out in **Schedule 2** to this Agreement) and
- (2) **the Borrower** (as defined in the Standard Terms)

WHEREAS the Borrower wishes the Loan to qualify as Financial Resources contributing to its Financial Resources Requirement, (as those expressions are defined in the Standard Terms) and has fully disclosed to the FSA the circumstances giving rise to the Loan or Facility and the effective subordination of the Loan.

IT IS AGREED THAT this Agreement shall comprise the Variable Terms set out in **Schedule 1** to this Agreement and the Standard Terms set out in **Schedule 2** to this Agreement.

This Agreement is executed by the parties the day and year indicated in the Variable Terms.

Schedule 1

B. Variable Terms

1. Date of Agreement	
2. Effective Date	
3. Lender	
4. Address of Lender	
5. Borrower	
6. Address of Borrower	

7. **The Loan or Facility**

With reference to paragraph 2 of the Standard Terms,

8. **Interest**

With reference to paragraph 3 of the Standard Terms, interest shall be calculated and paid as follows -

9. **Repayment**

With reference to paragraph 4(2) of the Standard Terms and subject always to paragraphs 4(3) (restrictions on repayment) and 5 (subordination) of the Standard Terms, the terms for repayment are -

[Empty rectangular box for repayment terms]

Notes to paragraph 9.

1. The repayment date for the Loan must be one or more of -
 - a date not less than five years from the date of drawdown,
 - a date not less than five years from the Lender giving notice in writing to the Borrower and the FSA, or
 - a date not less than five years from the Borrower giving notice in writing to the Lender and the FSA.
2. Where the Agreement is for a loan facility each Advance must be treated separately and have a repayment date not less than five years from the date of drawdown, or be subject to not less than five years' notice or have and be subject to both.

10. **Additional terms**

With reference to paragraph 11 of the Standard Terms, the additional terms to this Agreement are -

[Empty rectangular box for listing additional terms]

11. Jurisdiction

With reference to paragraph 16 of the Standard Terms, the person(s) indicated below is (are) appointed as agents for service of process -

(a) by the Lender -

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of

--

(b) by the Borrower -

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of

--

Schedule 2

C. Standard Terms

Interpretation

1 (1) In this Agreement -

“Advance” means, where this Agreement is for a loan facility, an amount drawn or to be drawn down by the Borrower or otherwise made available by the Lender under this Agreement as that amount may be reduced from time to time by any repayment or prepayment permitted under this Agreement;

“Borrower” means the person identified as such in the Variable Terms and includes its permitted successors and assigns and, where the Borrower is a partnership, each Partner;

“Business Day” means any day except Saturday, Sunday or a bank or public holiday in England;

“Effective Date” means the date on which this Agreement is to take effect being the date of this Agreement unless otherwise stated in the Variable Terms;

“Excluded Liabilities” means Liabilities which are expressed to be and, in the opinion of the Insolvency Officer of the Borrower, do, rank junior to the Subordinated Liabilities in any Insolvency of the Borrower;

“Facility” means the loan facility referred to in paragraph 2(2);

“Financial Resources”; means the financial resources which apply to the Borrower as calculated under rule 10-200(1) of the Financial Rules and are notifiable to the Borrower via its subsidiaries regulated by the FSA from time to time;

“Financial Resources Requirement” means the financial resources requirement which applies to the Borrower as calculated under rule 10-200(1) of the Financial Rules and are notifiable to the Borrower via its subsidiaries regulated by the FSA from time to time;

“Financial Rules” means the rules in IPRU(INV) 10 in the FSA handbook;

“Insolvency” means and includes liquidation, winding up, bankruptcy, sequestration, administration, rehabilitation and dissolution (whichever term may apply to the Borrower) or the equivalent in any other jurisdiction to which the Borrower may be subject;

“Insolvency Officer” means and includes any person duly appointed to administer and distribute assets of the Borrower in the course of the Borrower’s Insolvency;

- 1 (1) **“Lender”** means the person identified as such in the Variable Terms and includes its permitted successors and assigns;

“Liabilities” means all present and future sums, liabilities and obligations payable or owing by the Borrower (whether actual or contingent, jointly or severally or otherwise howsoever);

“Loan” means the indebtedness of the Borrower to the Lender referred to in paragraph 2(1) as that indebtedness may be reduced from time to time by any repayment or prepayment permitted under this Agreement;

“Partner” means, where the Borrower is a partnership, each and every partner of the Borrower as a partner and as an individual (see also paragraph 8);

“Senior Liabilities” means all Liabilities except the Subordinated Liabilities and Excluded Liabilities;

“Subordinated Liabilities” means all Liabilities to the Lender in respect of the Loan or each Advance made under this Agreement and all interest payable thereon.

“the FSA” means The Financial Services Authority Limited whose registered office is at 25 The North Colonnade, Canary Wharf, London, E14 5HS; and

- (2) Any reference to any rules of the FSA is a reference to them as in force from time to time.
- (3) Reference to any gender includes a reference to all other genders.
- (4) Reference to a paragraph is to a paragraph of these Standard Terms, unless otherwise indicated.

The Loan or Facility

- 2 (1) Where as indicated in the Variable Terms this Agreement is for a loan, the Borrower hereby acknowledges its indebtedness to the Lender in the sum mentioned in the Variable Terms as an unsecured loan upon and subject to the terms and conditions of this Agreement.
- (2) Where, as indicated in the Variable Terms this Agreement is for a loan facility -
- (a) the maximum aggregate principal amount of each Advance outstanding at any time under the Facility shall not exceed the maximum amount specified in the Variable Terms or such other amount as may be agreed between the Borrower and the Lender from time to time;
- (b) the Facility will be available until the last available date specified in the Variable Terms; and

- 2** (2) (c) any specific terms dealing with the mechanics of drawdown are contained in the Variable Terms.
- (3) The Lender and the Borrower undertake to provide the FSA, immediately upon request, with details in writing of all principal and interest in respect of the Loan or each Advance outstanding for the time being and all payments of any amount made in the period specified by the FSA in the request.

Interest

- 3** Subject to the provisions of paragraphs 4 and 5, until repayment of the Loan or each Advance in full, the Borrower will pay to the Lender interest on the Loan or each Advance (or on any part or parts of it or them for the time being outstanding under this Agreement) calculated and payable in the manner set out in the Variable Terms.

Repayment

- 4** (1) The provisions of this paragraph are subject in all respects to the provisions of paragraph 5(subordination).
- (2) The terms concerning repayment are set out in the Variable Terms but are subject to paragraph 4(3).
- (3) (a) Except where the FSA otherwise permits, no repayment, or prepayment of the Loan or any Advance may be made, in whole or in part, before the relevant repayment date provided for in paragraph 9 of the Variable Terms.
- (b) the FSA may permit the early repayment or prepayment of the Loan or any Advance, in whole or in part, only where, immediately after such repayment or prepayment, the Borrower's Financial Resources would be greater than 100% of its Financial Resources Requirement.
- (c) Payments of interest at a rate not exceeding the rate provided for in paragraph 3 may be made without notice to or consent of the FSA, except that where -
- (i) immediately after payment, the Borrower's Financial Resources would be less than or equal to 100% of its Financial Resources Requirement; or
- (ii) before payment, the Insolvency of the Borrower commences,
- no such payment may be made without the prior written consent of the FSA.
- (4) If in respect of the Loan or any Advance default is made for a period of -
- (a) seven days or more in the payment of any principal due, or
- (b) 14 days or more in the payment of any interest due,

- 4 (4) the Lender may, at its discretion and after taking such preliminary steps or actions as may be necessary, enforce payment by instituting proceedings for the Insolvency of the Borrower after giving seven Business Day's prior written notice to the FSA of its intention to do so.
- (5) Subject to (6) below, the Lender may at its discretion, subject as provided in this Agreement, institute proceedings for the Insolvency of the Borrower to enforce any obligation, condition or provision binding on the Borrower under this Agreement (other than any obligation for the payment of principal moneys or interest in respect of the Loan or any Advance) PROVIDED THAT the Borrower shall not by virtue of the institution of any such proceedings for the Insolvency of the Borrower be obliged to pay any sum or sums sooner than the same would otherwise have been payable by it.
- (6) The Lender may only institute proceedings for the Insolvency of the Borrower to enforce the obligations referred to in (5) above if -
- (a) a default under those obligations is not remedied to the satisfaction of the Lender within 60 days after notice of such default has been given to the Borrower by the Lender requiring such default to be remedied;
 - (b) the Lender has taken all preliminary steps or actions required to be taken by it prior to the institution of such proceedings; and
 - (c) the Lender has given seven Business Days' prior written notice to the FSA of its intention to institute such proceedings.
- (7) No remedy against the Borrower other than as specifically provided by this paragraph 4 shall be available to the Lender whether for the recovery of amounts owing under this Agreement or in respect of any breach by the Borrower of any of its obligations under this Agreement.

Subordination

- 5 (1) Notwithstanding the provisions of paragraph 4, the rights of the Lender in respect of the Subordinated Liabilities are subordinated to the Senior Liabilities and accordingly payment of any amount (whether principal, interest or otherwise) of the Subordinated Liabilities is conditional upon -
- (a) (if an order has not been made or an effective resolution passed for the Insolvency of the Borrower and, being a partnership, the Borrower has not been dissolved) the Borrower being in compliance with not less than 100% of its Financial Resources Requirement immediately after payment by the Borrower and accordingly no such amount which would otherwise fall due for payment shall be payable except to the extent that -
 - (i) paragraph 4(3) has been complied with; and

- 5 (1) (a) (ii) the Borrower could make such payment and still be in compliance with such Financial Resources Requirement; and
- (b) the Borrower being “solvent” at the time of, and immediately after, the payment by the Borrower and accordingly no such amount which would otherwise fall due for payment shall be payable except to the extent that the Borrower could make such payment and still be “solvent”.
- (2) For the purposes of sub-paragraph (1)(b) above, the Borrower shall be “solvent” if it is able to pay its Liabilities (other than the Subordinated Liabilities) in full disregarding -
- (a) obligations which are not payable or capable of being established or determined in the Insolvency of the Borrower, and
- (b) the Excluded Liabilities.
- (3) Interest will continue to accrue at the rate specified pursuant to paragraph 3 on any payment which does not become payable under this paragraph 5.
- (4) For the purposes of sub-paragraph (1)(b) above, a report given at any relevant time as to the solvency of the Borrower by its Insolvency Officer, in form and substance acceptable to the FSA, shall in the absence of proven error be treated and accepted by the FSA, the Lender and the Borrower as correct and sufficient evidence of the Borrower’s solvency or Insolvency.
- (5) Subject to the provisions of sub-paragraphs (6), (7) and (8) below, if the Lender shall receive from the Borrower payment of any sum in respect of the Subordinated Liabilities -
- (a) when any of the terms and conditions referred to in sub-paragraph (1) above is not satisfied, or
- (b) where such payment is prohibited under paragraph 4(3),
- the payment of such sum shall be void for all purposes.
- (6) Any sum referred to in sub-paragraph (5) above shall be received by the Lender upon trust to return it to the Borrower.
- (7) Any sum so returned shall then be treated for the purposes of the Borrower’s obligations hereunder as if it had not been paid by the Borrower and its original payment shall be deemed not to have discharged any of the obligations of the Borrower hereunder.
- (8) A request to the Lender for return of any sum referred to in sub-paragraph (5) shall be in writing and shall be made by or on behalf of the Borrower or, as the case may be, its Insolvency Officer.

Representations and undertakings of Borrower

- 6** From and after the date of this Agreement (or the Effective Date if earlier), the Borrower shall not without the prior written consent of the FSA -
- (a) secure all or any part of the Subordinated Liabilities;
 - (b) redeem, purchase or otherwise acquire any of the Subordinated Liabilities;
 - (c) amend any document evidencing or providing for the Subordinated Liabilities;
 - (d) repay any of the Subordinated Liabilities otherwise than in accordance with the terms of this Agreement;
 - (e) take or omit to take any action whereby the subordination of the Subordinated Liabilities or any part thereof to the Senior Liabilities might be terminated, impaired or adversely affected; or
 - (f) arrange or permit any contract of suretyship (or similar agreement) relating to its liabilities under this Agreement to be entered into, and

other than as disclosed in writing to the FSA, the Borrower represents that it has not done so before the date of this Agreement (or the Effective Date if earlier).

Representations and undertakings of Lender

- 7** From and after the date of this Agreement (or the Effective Date if earlier), the Lender shall not without the prior written consent of the FSA -
- (a) assign, transfer, dispose of or encumber the whole or any part of the Subordinated Liabilities or purport to do so in favour of any person;
 - (b) purport to retain or set off at any time any amount payable by it to the Borrower against any amount of the Subordinated Liabilities except to the extent that payment of such amount of the Subordinated Liabilities would be permitted at such time by this Agreement, and the Lender shall immediately pay an amount equal to any retention or set off in breach of this provision to the Borrower and such retention or set off shall be deemed not to have occurred;
 - (c) amend or waive the terms of any document evidencing or providing for the Subordinated Liabilities;
 - (d) attempt to obtain repayment of any of the Subordinated Liabilities otherwise than in accordance with the terms of this Agreement;
 - (e) take or omit to take any action whereby the subordination of the Subordinated Liabilities or any part of them to the Senior Liabilities might be terminated, impaired or adversely affected; or

- 7 (f) take or enforce any security, guarantee or indemnity from any person for all or any part of the Subordinated Liabilities, and the Lender shall, upon obtaining or enforcing any security, guarantee or indemnity notwithstanding this undertaking, hold the same (and any proceeds thereof) on trust for the Borrower, and

other than as disclosed in writing to the FSA, the Lender represents that it has not done so before the date of this Agreement (or the Effective Date if earlier).

Borrower being a partnership

- 8 Where the Borrower is a partnership -

(a) this Agreement shall subsist in full force and effect notwithstanding any change which may take place from time to time in the constitution or title of the Borrower by the retirement of the present Partners or any of them or the assumption of new Partners or by a change of name PROVIDED THAT -

(i) a retired Partner shall continue to be liable for the payment of all sums due under this Agreement and implementation of all other obligations in this Agreement until the Lender and the remaining Partner(s) shall agree in writing to release a retired Partner from those obligations and the FSA has agreed in writing to the release; and

(ii) in the event of a new Partner being assumed as a partner of the Borrower the other Partners shall procure that said assumed Partner shall become bound to the Lender as a party to this Agreement and shall execute such addendum hereto as the Lender and the FSA may consider necessary;

(b) the obligations and undertakings of the Borrower under this Agreement shall bind the Borrower and the Partners jointly and severally.

Partial invalidity

- 9 If any of the provisions of this Agreement is or becomes invalid, illegal or unenforceable under any law, the validity, legality and enforceability of the remaining provisions shall not in any way be affected or impaired.

The FSA and indemnity

- 10 The FSA shall not be taken to be a trustee or other fiduciary for, or have any obligations to, any person to whom some or all of the Senior Liabilities are owed. Each of the Lender and Borrower shall on demand indemnify the FSA against all claims, losses, costs, expenses and other liabilities made against or incurred by the FSA as a consequence of it taking action for breach of this Agreement.

Additional terms

- 11** Any additional terms agreed between the parties are set out in the Variable Terms provided that, if there is any inconsistency between the Variable Terms and the Standard Terms, the Standard Terms shall prevail.

Entire agreement

- 12** This Agreement forms the entire agreement as to the Subordinated Liabilities. If there are any other terms relating to the Subordinated Liabilities existing at the date hereof and not comprised in this Agreement such terms shall be of no further force and effect.

Amendments

- 13** Any amendments to this Agreement made or purported to be made without the consent of the FSA shall be void.

Notices to the FSA

- 14** A notice given to the FSA under this Agreement shall have no effect, and time shall not start to run in connection with that notice, until the FSA has given to the sender written confirmation of its receipt.

Law

- 15** This Agreement is governed by English law.

Jurisdiction

- 16** For the benefit of the FSA solely, each of the Borrower and the Lender irrevocably submits to the jurisdiction of the English Courts and, to the extent that it does not have a place of business within the jurisdiction, appoints the process agent specified in the Variable Terms as agent for receipt of service of process in such courts. Such jurisdiction shall be non-exclusive except to the extent that non-exclusivity prejudices the submission to the jurisdiction.

Approved Form Of Subordinated Loan Agreement

D. Signature Page

10.7 Approved Form of Short-Term Subordinated Loan Agreement for the purposes of Consolidated Supervision

A. Front Page

THIS AGREEMENT is made on the date set out in the Variable Terms (as set out in **Schedule 1** to this Agreement) and is to be effective on that date unless a different effective date is set out in those terms

BETWEEN -

- (1) **the Lender** (as defined in the Standard Terms set out in **Schedule 2** to this Agreement), and
- (2) **the Borrower** (as defined in the Standard Terms)

WHEREAS the Borrower wishes the Loan to qualify as Financial Resources contributing to its Financial Resources Requirement, (as those expressions are defined in the Standard Terms) and has fully disclosed to the FSA the circumstances giving rise to the Loan or Facility and the effective subordination of the Loan.

IT IS AGREED THAT this Agreement shall comprise the Variable Terms set out in **Schedule 1** to this Agreement and the Standard Terms set out in **Schedule 2** to this Agreement.

This Agreement is executed by the parties the day and year indicated in the Variable Terms.

Schedule 1

B. Variable Terms

1. Date of Agreement	
2. Effective Date	
3. Lender	
4. Address of Lender	
5. Borrower	
6. Address of Borrower	

7. **The Loan or Facility**

With reference to paragraph 2 of the Standard Terms,

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8. **Interest**

With reference to paragraph 3 of the Standard Terms, interest shall be calculated and paid as follows -

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9. **Repayment**

With reference to paragraph 4(2) of the Standard Terms and subject always to paragraphs 4(3) (restrictions on repayment) and 5 (subordination) of the Standard Terms, the terms for repayment are -

Notes to paragraph 9.

1. The repayment date for the Loan must be one or more of -
 - a date not less than two years from the date of drawdown,
 - a date not less than two years from the Lender giving notice in writing to the Borrower and the FSA, or
 - a date not less than two years from the Borrower giving notice in writing to the Lender and the FSA.
2. Where the Agreement is for a loan facility each Advance must be treated separately and have a repayment date not less than two years from the date of drawdown, or be subject to not less than two years' notice or have and be subject to both.

10. **Additional terms**

With reference to paragraph 11 of the Standard Terms, the additional terms to this Agreement are -

[Empty rectangular box for listing additional terms]

11. Jurisdiction

With reference to paragraph 16 of the Standard Terms, the person(s) indicated below is (are) appointed as agents for service of process -

(a) by the Lender -

--

of

--

(b) by the Borrower -

--

of

--

Schedule 2

C. Standard Terms

Interpretation

1 (1) In this Agreement -

“**Advance**” means, where this Agreement is for a loan facility, an amount drawn or to be drawn down by the Borrower or otherwise made available by the Lender under this Agreement as that amount may be reduced from time to time by any repayment or prepayment permitted under this Agreement;

“**Borrower**” means the person identified as such in the Variable Terms and includes its permitted successors and assigns and, where the Borrower is a partnership, each Partner;

“**Business Day**” means any day except Saturday, Sunday or a bank or public holiday in England;

“**Effective Date**” means the date on which this Agreement is to take effect being the date of this Agreement unless otherwise stated in the Variable Terms;

“**Excluded Liabilities**” means Liabilities which are expressed to be and, in the opinion of the Insolvency Officer of the Borrower, do, rank junior to the Subordinated Liabilities in any Insolvency of the Borrower;

“**Facility**” means the loan facility referred to in paragraph 2(2);

“**Financial Resources**” means the financial resources which apply to the Borrower as calculated under rule 10-200(1) of the Financial Rules and are notifiable to the Borrower via its subsidiaries regulated by the FSA from time to time;

“**Financial Resources Requirement**” means the financial resources requirement which applies to the Borrower as calculated under rule 10-200(1) of the Financial Rules and are notifiable to the Borrower via its subsidiaries regulated by the FSA from time to time.

“**Financial Rules**” means the rules in IPRU(INV) 10 of the FSA handbook;

“**Insolvency**” means and includes liquidation, winding up, bankruptcy, sequestration, administration, rehabilitation and dissolution (whichever term may apply to the Borrower) or the equivalent in any other jurisdiction to which the Borrower may be subject;

“**Insolvency Officer**” means and includes any **person** duly appointed to administer and distribute assets of the Borrower in the course of the Borrower’s Insolvency;

- 1 (1) **“Lender”** means the person identified as such in the **Variable** Terms and includes its permitted successors and assigns;

“Liabilities” means all present and future sums, liabilities and obligations payable or owing by the Borrower (whether actual or contingent, jointly or severally or otherwise howsoever);

“Loan” means the indebtedness of the Borrower to the Lender referred to in paragraph 2(1) as that indebtedness may be reduced from time to time by any repayment or prepayment permitted under this Agreement;

“Partner” means, where the Borrower is a partnership, each and every partner of the Borrower as a partner and as an individual (see also paragraph 8);

“Senior Liabilities” means all Liabilities except the Subordinated Liabilities and Excluded Liabilities;

“Subordinated Liabilities” means all Liabilities to the Lender in respect of the Loan or each Advance made under this Agreement and all interest payable thereon.

“the FSA” means The Financial Services Authority Limited whose registered office is at 25 The North Colonnade, Canary Wharf, London, E14 5HS; and

- (2) Any reference to any rules of the FSA is a reference to them as in force from time to time.
- (3) Reference to any gender includes a reference to all other genders.
- (4) Reference to a paragraph is to a paragraph of these Standard Terms, unless otherwise indicated.

The Loan or Facility

- 2 (1) Where as indicated in the Variable Terms this Agreement is for a loan, the Borrower hereby acknowledges its indebtedness to the Lender in the sum mentioned in the Variable Terms as an unsecured loan upon and subject to the terms and conditions of this Agreement.
- (2) Where, as indicated in the Variable Terms this Agreement is for a loan facility -
- (a) the maximum aggregate principal amount of each Advance outstanding at any time under the Facility shall not exceed the maximum amount specified in the Variable Terms or such other amount as may be agreed between the Borrower and the Lender from time to time;
- (b) the Facility will be available until the last available date specified in the Variable Terms; and

- 2** (2) (c) any specific terms dealing with the mechanics of drawdown are contained in the Variable Terms.
- (3) The Lender and the Borrower undertake to provide the FSA, immediately upon request, with details in writing of all principal and interest in respect of the Loan or each Advance outstanding for the time being and all payments of any amount made in the period specified by the FSA in the request.

Interest

- 3** Subject to the provisions of paragraphs 4 and 5, until repayment of the Loan or each Advance in full, the Borrower will pay to the Lender interest on the Loan or each Advance (or on any part or parts of it or them for the time being outstanding under this Agreement) calculated and payable in the manner set out in the Variable Terms.

Repayment

- 4** (1) The provisions of this paragraph are subject in all respects to the provisions of paragraph 5(subordination).
- (2) The terms concerning repayment are set out in the Variable Terms but are subject to paragraph 4(3).
- (3) (a) Except where the FSA otherwise permits, no repayment, or prepayment of the Loan or any Advance may be made, in whole or in part, before the relevant repayment date provided for in paragraph 9 of the Variable Terms.
- (b) the FSA may permit the early repayment or prepayment of the Loan or any Advance, in whole or in part, only where, immediately after such repayment or prepayment, the Borrower's Financial Resources would be greater than 100% of its Financial Resources Requirement.
- (c) Payments of interest at a rate not exceeding the rate provided for in paragraph 3 may be made without notice to or consent of the FSA, except that where -
- (i) immediately after payment, the Borrower's Financial Resources would be less than or equal to 100% of its Financial Resources Requirement; or
- (ii) before payment, the Insolvency of the Borrower commences,
- no such payment may be made without the prior written consent of the FSA.
- (4) If in respect of the Loan or any Advance default is made for a period of -
- (a) seven days or more in the payment of any principal due, or
- (b) 14 days or more in the payment of any interest due,

- 4 (4) the Lender may, at its discretion and after taking such preliminary steps or actions as may be necessary, enforce payment by instituting proceedings for the Insolvency of the Borrower after giving seven Business Day's prior written notice to the FSA of its intention to do so.
- (5) Subject to (6) below, the Lender may at its discretion, subject as provided in this Agreement, institute proceedings for the Insolvency of the Borrower to enforce any obligation, condition or provision binding on the Borrower under this Agreement (other than any obligation for the payment of principal moneys or interest in respect of the Loan or any Advance) PROVIDED THAT the Borrower shall not by virtue of the institution of any such proceedings for the Insolvency of the Borrower be obliged to pay any sum or sums sooner than the same would otherwise have been payable by it.
- (6) The Lender may only institute proceedings for the Insolvency of the Borrower to enforce the obligations referred to in (5) above if -
- (a) a default under those obligations is not remedied to the satisfaction of the Lender within 60 days after notice of such default has been given to the Borrower by the Lender requiring such default to be remedied;
 - (b) the Lender has taken all preliminary steps or actions required to be taken by it prior to the institution of such proceedings; and
 - (c) the Lender has given seven Business Days' prior written notice to the FSA of its intention to institute such proceedings.
- (7) No remedy against the Borrower other than as specifically provided by this paragraph 4 shall be available to the Lender whether for the recovery of amounts owing under this Agreement or in respect of any breach by the Borrower of any of its obligations under this Agreement.

Subordination

- 5 (1) Notwithstanding the provisions of paragraph 4, the rights of the Lender in respect of the Subordinated Liabilities are subordinated to the Senior Liabilities and accordingly payment of any amount (whether principal, interest or otherwise) of the Subordinated Liabilities is conditional upon -
- (a) (if an order has not been made or an effective resolution passed for the Insolvency of the Borrower and, being a partnership, the Borrower has not been dissolved) the Borrower being in compliance with not less than 100% of its Financial Resources Requirement immediately after payment by the Borrower and accordingly no such amount which would otherwise fall due for payment shall be payable except to the extent that -
 - (i) paragraph 4(3) has been complied with; and

- 5 (1) (a) (ii) the Borrower could make such payment and still be in compliance with such Financial Resources Requirement; and

the Borrower being “solvent” at the time of, and immediately after, the payment by the Borrower and accordingly no such amount which would otherwise fall due for payment shall be payable except to the extent that the Borrower could make such payment and still be “solvent”.

- (2) For the purposes of sub-paragraph (1)(b) above, the Borrower shall be “solvent” if it is able to pay its Liabilities (other than the Subordinated Liabilities) in full disregarding -

(a) obligations which are not payable or capable of being established or determined in the Insolvency of the Borrower, and

(b) the Excluded Liabilities.

- (3) Interest will continue to accrue at the rate specified pursuant to paragraph 3 on any payment which does not become payable under this paragraph 5.

- (4) For the purposes of sub-paragraph (1)(b) above, a report given at any relevant time as to the solvency of the Borrower by its Insolvency Officer, in form and substance acceptable to the FSA, shall in the absence of proven error be treated and accepted by the FSA, the Lender and the Borrower as correct and sufficient evidence of the Borrower’s solvency or Insolvency.

- (5) Subject to the provisions of sub-paragraphs (6), (7) and (8) below, if the Lender shall receive from the Borrower payment of any sum in respect of the Subordinated Liabilities -

(a) when any of the terms and conditions referred to in sub-paragraph (1) above is not satisfied, or

(b) where such payment is prohibited under paragraph 4(3),

the payment of such sum shall be void for all purposes.

- (6) Any sum referred to in sub-paragraph (5) above shall be received by the Lender upon trust to return it to the Borrower.

- (7) Any sum so returned shall then be treated for the purposes of the Borrower’s obligations hereunder as if it had not been paid by the Borrower and its original payment shall be deemed not to have discharged any of the obligations of the Borrower hereunder.

- 5 (8) A request to the Lender for return of any sum referred to in sub-paragraph (5) shall be in writing and shall be made by or on behalf of the Borrower or, as the case may be, its Insolvency Officer.

Representations and undertakings of Borrower

- 6 From and after the date of this Agreement (or the Effective Date if earlier), the Borrower shall not without the prior written consent of the FSA -

- (a) secure all or any part of the Subordinated Liabilities;
- (b) redeem, purchase or otherwise acquire any of the Subordinated Liabilities;
- (c) amend any document evidencing or providing for the Subordinated Liabilities;
- (d) repay any of the Subordinated Liabilities otherwise than in accordance with the terms of this Agreement;
- (e) take or omit to take any action whereby the subordination of the Subordinated Liabilities or any part thereof to the Senior Liabilities might be terminated, impaired or adversely affected; or
- (f) arrange or permit any contract of suretyship (or similar agreement) relating to its liabilities under this Agreement to be entered into, and

other than as disclosed in writing to the FSA, the Borrower represents that it has not done so before the date of this Agreement (or the Effective Date if earlier).

Representations and undertakings of Lender

- 7 From and after the date of this Agreement (or the Effective Date if earlier), the Lender shall not without the prior written consent of the FSA -

- (a) assign, transfer, dispose of or encumber the whole or any part of the Subordinated Liabilities or purport to do so in favour of any person;
- (b) purport to retain or set off at any time any amount payable by it to the Borrower against any amount of the Subordinated Liabilities except to the extent that payment of such amount of the Subordinated Liabilities would be permitted at such time by this Agreement, and the Lender shall immediately pay an amount equal to any retention or set off in breach of this provision to the Borrower and such retention or set off shall be deemed not to have occurred;
- (c) amend or waive the terms of any document evidencing or providing for the Subordinated Liabilities;
- (d) attempt to obtain repayment of any of the Subordinated Liabilities otherwise than in accordance with the terms of this Agreement;

- 7 (e) take or omit to take any action whereby the subordination of the Subordinated Liabilities or any part of them to the Senior Liabilities might be terminated, impaired or adversely affected; or
- (f) take or enforce any security, guarantee or indemnity from any person for all or any part of the Subordinated Liabilities, and the Lender shall, upon obtaining or enforcing any security, guarantee or indemnity notwithstanding this undertaking, hold the same (and any proceeds thereof) on trust for the Borrower, and

other than as disclosed in writing to the FSA, the Lender represents that it has not done so before the date of this Agreement (or the Effective Date if earlier).

Borrower being a partnership

8 Where the Borrower is a partnership -

- (a) this Agreement shall subsist in full force and effect notwithstanding any change which may take place from time to time in the constitution or title of the Borrower by the retirement of the present Partners or any of them or the assumption of new Partners or by a change of name PROVIDED THAT -
- (i) a retired Partner shall continue to be liable for the payment of all sums due under this Agreement and implementation of all other obligations in this Agreement until the Lender and the remaining Partner(s) shall agree in writing to release a retired Partner from those obligations and the FSA has agreed in writing to the release; and
- (ii) in the event of a new Partner being assumed as a partner of the Borrower the other Partners shall procure that said assumed Partner shall become bound to the Lender as a party to this Agreement and shall execute such addendum hereto as the Lender and the FSA may consider necessary;
- (b) the obligations and undertakings of the Borrower under this Agreement shall bind the Borrower and the Partners jointly and severally.

Partial invalidity

- 9 If any of the provisions of this Agreement is or becomes invalid, illegal or unenforceable under any law, the validity, legality and enforceability of the remaining provisions shall not in any way be affected or impaired.

The FSA and indemnity

- 10** The FSA shall not be taken to be a trustee or other fiduciary for, or have any obligations to, any person to whom some or all of the Senior Liabilities are owed. Each of the Lender and Borrower shall on demand indemnify the FSA against all claims, losses, costs, expenses and other liabilities made against or incurred by the FSA as a consequence of it taking action for breach of this Agreement.

Additional terms

- 11** Any additional terms agreed between the parties are set out in the Variable Terms provided that, if there is any inconsistency between the Variable Terms and the Standard Terms, the Standard Terms shall prevail.

Entire agreement

- 12** This Agreement forms the entire agreement as to the Subordinated Liabilities. If there are any other terms relating to the Subordinated Liabilities existing at the date hereof and not comprised in this Agreement such terms shall be of no further force and effect.

Amendments

- 13** Any amendments to this Agreement made or purported to be made without the consent of the FSA shall be void.

Notices to the FSA

- 14** A notice given to the FSA under this Agreement shall have no effect, and time shall not start to run in connection with that notice, until the FSA has given to the sender written confirmation of its receipt.

Law

- 15** This Agreement is governed by English law.

Jurisdiction

- 16** For the benefit of the FSA solely, each of the Borrower and the Lender irrevocably submits to the jurisdiction of the English Courts and, to the extent that it does not have a place of business within the jurisdiction, appoints the process agent specified in the Variable Terms as agent for receipt of service of process in such courts. Such jurisdiction shall be non-exclusive except to the extent that non-exclusivity prejudices the submission to the jurisdiction.

Approved Form Of Subordinated Loan Agreement

D. Signature Page

10.8 Guidance Notes on Completion of Agreements

A GENERAL

Introduction

1. These Notes are designed to accompany the Approved Forms of Subordinated Loan Agreement, each of which is in four parts: the front page, the Variable Terms in Schedule 1, the Standard Terms in Schedule 2 and the signature page. The parties will need to set out details of themselves and the transaction in the Variable Terms and complete the signature page. The front page and the Standard Terms should remain unaltered.
2. All communications with the FSA regarding the proposed Agreement should in the first instance be via the firm's inspector.

ISD/Non-ISD

3. Firms are advised to ensure that the appropriate form of ISD (Chap.10)/non-ISD (Chap.3) subordinated loan agreement is used. This is, of course, dependent on the firm's authorisation categorisation. Should the firm's categorisation be changing from ISD to non-ISD (or vice versa), this should be discussed with the firm's inspector as it is likely that any subordinated loan agreement in place will have to be revised. Subordinated loan agreements for ISD firms are further classified as either short-term or long-term - this turns on whether the loan is to have an original maturity period of at least 2 or 5 years.

Preparation of the Agreement

4. (a) The form containing the Variable Terms may be completed or re-typed according to preference.
(b) Rather than re-type the Standard Terms (Schedule 2), firms should simply **photocopy Schedule 2 of the FSA precedent or print it from the website and include it as part of the original Agreement.**
5. [Deleted]

Financial Rules IPRU(INV) 10-63

6. Firms are referred to rule IPRU(INV) 10-63 on the use of subordinated loans, including restrictions on approved lenders, repayment provisions and gearing limits.

B NOTES ON VARIABLE TERMS

Dates

7. If the **Effective Date of the Agreement** is to be different from the Date of the Agreement, care should be taken to record this in paragraph 2. Where this is the case, the Effective Date will normally be expected to be later than the Date of the Agreement. If the Effective Date is to be a date prior to the date of the Agreement (for example because the loan was drawn down before the Agreement was put in place), the firm will be expected to provide a reasonable explanation to the FSA as to why it was not possible to document the loan more promptly.

Addresses

8. Paragraphs 4 and 6: The address given should be the firm's registered office or equivalent.

Partnerships

9. Paragraph 5: Where the Borrower is a partnership, insert "See Additional Terms, paragraph 10() below" and in paragraph 10 of Schedule 1, insert the names and addresses of each of the partners.

The Loan or Facility

10. Paragraph 7: Check that paragraph 2 of the Standard Terms accurately reflects the intentions of the parties.

11. Suggested wording for a loan is:

"This is an agreement for the Loan of £[]."

12. Suggested wording for a facility is:

"This is an agreement for a Facility under which the Lender is committed to make Advances in pounds sterling to the Borrower up to a maximum amount of £[] until the last available date of the Facility being [.....(date)]."

The terms (if any) agreed between the parties on the mechanics of drawdown are as follows - ". *

- * For example, the parties may wish to provide that:

"Advances may be drawdown in integral multiples of £100,000."

Interest

13. Paragraph 8: the FSA will be concerned if an excessive rate of interest compared with the market rate is charged. Broadly speaking a rate of interest will be regarded by the FSA as excessive if it is not a commercial one. Compound interest is not acceptable.

Repayment

14. Irrespective of the form of agreement being used, the specified notice period runs from the date of drawdown and, therefore, where a loan is in the form of a facility, each advance must be for a minimum of the required period.
15. Repayment clauses have given rise to confusion in the past. The wording of such clauses will differ depending on whether an ISD long-term, an ISD short-term or a non-ISD form is being used. Sample wordings for each of these forms of agreement are set out below.

ISD: Long-term form

16. Firms are advised that for an ISD long-term form the repayment date must be a specified date not less than 5 years from one or more of:
 - the date of drawdown;
 - the borrower giving notice in writing to the lender and the FSA; or
 - the lender giving notice in writing to the borrower and the FSA.
17. Paragraph 9: Examples of suggested wordings for either a fixed repayment date or repayment on notice for a long-term form are as follows:
 - (a) "The Borrower shall repay [the Loan/each Advance made to it] on the [date which falls five years after the date] [fifth anniversary]of drawdown of the [Loan/relevant Advance]."
 - (b) "The Borrower shall repay [the Loan/each Advance made to it] five years after the date on which:
 - (a) the Borrower gives written notice to the Lender and to the FSA; or
 - (b) the Lender gives written notice to the Borrower and to the FSA."Note: either (a) or (b) above by itself is sufficient.
 - (c) "[The Loan / Each Advance made to the Borrower] shall be repayable on the date specified by notice in writing given by the Lender to the Borrower and to the FSA or notice in writing given by the Borrower to the Lender and to the FSA, in either case that date being not less than five years after the date on which the notice is given."

ISD: Short-term form

18. For short-term agreements the applicable repayment period is at least two years, rather than five years as required for a long-term form, but otherwise the requirements are as above.

19 Paragraph 9: Examples of suggested wordings for either a fixed repayment date or repayment on notice for a short-term form are as follows:

(a) "The Borrower shall repay [the Loan/each Advance made to it] on the [date which falls two years after the date] [second anniversary] of drawdown of the [Loan/relevant Advance]."

(b) "The Borrower shall repay [the Loan/each Advance made to it] two years after the date on which:

(a) the Borrower gives written notice to the Lender and to the FSA; or

(b) the Lender gives written notice to the Borrower and to the FSA."

Note: either (a) or (b) above by itself is sufficient.

(c) "[The Loan / Each Advance made to the Borrower] shall be repayable on the date specified by notice in writing given by the Lender to the Borrower and to the FSA or notice in writing given by the Borrower to the Lender and to the FSA, in either case that date being not less than two years after the date on which the notice is given."

Additional terms

20. Paragraph 10: Additional terms may be agreed between the borrower and lender such as those relating to -

- representations and warranties
- provision of financial and other information
- covenants
- costs and expenses
- taxes and increased costs
- mechanics of payment
- notices
- termination provisions.

However, they should not be inconsistent with the Agreement or the FSA rules. For example, any terms dealing with additional payments by the borrower (eg to compensate for taxes or increased costs) should be subject to the FSA's prior written consent. Covenants and additional representations and warranties should not be inconsistent with the existing representations and warranties in paragraphs 6 and 7 of the Standard Terms. Similarly, any notices clause should take into account paragraph 14 of the Standard Terms (notices to the FSA of no effect until receipt confirmed). Any inconsistency between the Variable Terms and the Standard Terms is resolved in favour of the Standard Terms (paragraph 11 of the Standard Terms).

21. The lender and borrower should note that the action which can be taken by the lender in response to any breach of representation, warranty or covenant by the borrower is considerably constrained by paragraphs 4 and 5 of the Standard Terms. Therefore the value to the lender of including additional representations, warranties or covenants is very limited.
22. See also note 9 above for the situation where the borrower is a partnership and notes 24 -25 below for additional terms relating to law and jurisdiction.

Law and jurisdiction

23. If the borrower or lender is resident in another jurisdiction and does not have a branch office within the United Kingdom, paragraph 11 of the Variable Terms should be completed.
24. The borrower should not be appointed agent for service of process on the lender in case a dispute arises between them.

C NOTES ON STANDARD TERMS

Representations and undertakings

25. Paragraphs 6(f) and 7(f): The guarantor or other provider of security must waive its right of subrogation against the borrower until all Senior Liabilities of the borrower have been paid in full. A form of deed for this purpose is available from the FSA.
26. On the effect of other terms relating to the subordinated liabilities not contained in this Agreement, see also paragraph 12 of the Standard Terms.
27. Paragraphs 15 and 16: See Notes 24-25 above.

D SIGNATURE PAGE

Arrangements for execution

28. **Two identical original Agreements** (i.e. the front page, the two Schedules and the signature page, each copy stapled or otherwise bound together) should be prepared for signature. Firms and lenders may use any of the execution forms set out in Notes 34-35 below.

E DEEDS OF VARIATION/ DEEDS OF TERMINATION

30. Firms are advised to ensure that the appropriate standard the FSA form is used. These forms are available from the FSA on request.

31. The recitals to the deed should refer to the amount of the loan/ each advance and where applicable, briefly summarise the effect of any previous variation of the agreement and of variation of the original agreement which is currently proposed.
32. A variation or termination of a subordinated loan agreement can only be effected by the execution of a further deed. In particular, this means that the formalities for executing a deed (see note 34-36 below) must be observed for all deeds of variation or termination and that all parties to the original agreement must also be parties to the subsequent deed of variation or termination. Only the forms set out at Notes 35(1) and (2) or 36(2) below are appropriate for execution as a deed.
33. A deed of variation will be required where the parties wish to change the terms of a subordinated loan agreement eg. where the amount of the loan or advance is to be increased. A deed of termination is needed where the parties wish to bring to terminate an agreement that is in place before it would otherwise come to an end. This could occur, for example, where the firm wants to substitute a new lender. Please note that where a subordinated loan agreement is terminated in this way, all obligations and liabilities of the parties arising before the date of termination remain in effect.

F Execution

34. In the case of English companies, reference is made to sections 36 and 36A of the Companies Act 1985 under which a company may contract
 - under its common seal
 - through any person acting under its authority, express or implied,

and a document signed by a director and the secretary of the company or by two directors and expressed to be executed by the company as a deed has the same effect as if executed under the common seal of the company.

35. Suggested wordings for English companies are:

(1) THE COMMON SEAL OF

[]
was hereunto affixed
in the presence of

.....
Director

.....
Director/secretary

OR

(2) EXECUTED as a deed

by

.....
Director

.....
Director/secretary

(3) SIGNED for and on behalf of

[]

by

.....
Authorised signatory

(4) SIGNED for and on behalf of

[]

by

.....
Director

.....
Director/secretary

**13 Personal Investment Firms
(former PIA firms)**

Form	Page
13.1 Form of subordinated loan (with guidance notes)	2

13.1 FORM OF SUBORDINATED LOAN AGREEMENT FOR PERSONAL INVESTMENT FIRMS (SEE IPRU (INV) 13)

NOTES FOR COMPLETION OF THIS DOCUMENT

This subordinated loan Agreement is to be used for injecting additional funds into a firm on a semi-permanent basis. This loan should normally be made in cash. You should speak to FSA before completing the Agreement if you intend to make the loan by a transfer or assignment of assets.

- (1) *This is the standard form prescribed by FSA for long term or short term subordinated loans. A long term subordinated loan must have an original maturity of at least five years or, where it has no fixed term, be subject to five years' notice of repayment; a short term subordinated loan must have an original maturity of at least two years or, where it has no fixed term, be subject to two years' notice of repayment. Delete from the heading and from paragraph 4(2) (Repayment of the Loan) whichever period in brackets is not relevant.*
- (2) *In paragraph 2, you should insert the Effective Date of the Loan, that is, the date on which the Lender will make the advance, if this differs from the date of the Agreement.*
- (3) *Words in brackets marked with a double asterisk ** are for use where the Borrower is a partnership.*

Governing Law

Number of crosses	Governing Law
+	Scottish
++	Scottish or Northern Irish
+++	English or Northern Irish
++++	Northern Irish
+++++	English

*Example: Words marked ++** will be for use where the Borrower is a partnership and the Agreement is governed by either Scottish or Northern Irish law.*

- (4) *Words in round brackets in paragraph 10 are only required where either the Lender or Borrower (or both) is not incorporated in any part of the United Kingdom.*
- (5) *You should speak to FSA before changing or amending this standard form (for example, by adding provisions relating to the terms of the Loan to be made to the Borrower by the Lender). FSA reserves the right to make a charge for considering any non-standard agreement.*

BETWEEN:-

- (1) [] of
[]
(the “Lender” which term includes its permitted successors and assigns); and
- (2) [] of
[]
(the “Borrower” which term includes its permitted successors and assigns); [and
[] of
[],
[] of
[] and
[] of
[]
the individual partners of the Borrower as such partners and as individuals]

IT IS AGREED AS FOLLOWS:-

1. DEFINITIONS

In this agreement:-

“**Effective Date**” means the date on which this Agreement is to take effect being the date of the Agreement unless otherwise stated in paragraph 2;

“**Excluded Liabilities**” means Liabilities which are expressed to be and, in the opinion of the Insolvency Officer of the Borrower, do rank junior to the Subordinated Liabilities in any Insolvency of the Borrower;

“**Financial Resource Requirement**” means 120 per cent. of the minimum amount of financial resources which the Borrower is required by FSA to maintain at any particular time in compliance with the Rules in chapter 13 of the Interim Prudential Sourcebook (“IPRU (INV)”) and any provisions amending or replacing them;

“**Insolvency**” means and includes liquidation, winding up, bankruptcy, sequestration, administration or dissolution (whichever term may apply to the Borrower) or the equivalent in any other jurisdiction to which the Borrower may be subject;

“**Insolvency Officer**” means and includes any person duly appointed to administer and distribute assets of the Borrower in the course of the Borrower’s Insolvency;

“**Liabilities**” means all present and future sums, liabilities and obligations payable or owing by the Borrower [or any Partner **] (whether actual or contingent, jointly or severally or otherwise howsoever);

“**Loan**” means the indebtedness of the Borrower to the Lender referred to in paragraph 2 as that indebtedness may be reduced from time to time by any repayment or prepayment permitted under this Agreement;

[“**Partner**” means an individual partner of the Borrower**];

“**Rules**” means the Rules of FSA from time to time in force;

“**Senior Liabilities**” means all Liabilities except the Subordinated Liabilities and Excluded Liabilities;

“**Subordinated Liabilities**” means all Liabilities to the Lender in respect of the Loan and all interest payable thereon.

2. LOAN

The Borrower hereby acknowledges its indebtedness to the Lender in the sum of [] as an unsecured loan upon and subject to the terms and conditions of this Agreement.

[Note: This paragraph may be adapted to reflect the actual basis on which the unsecured Loan arises and, if applicable, how it is to be drawn down. Members are requested to specify clearly the Effective Date of the Loan if it will differ from the date of the Agreement.]

3. INTEREST

Subject to the provisions of paragraphs 4 and 5, until repayment of the Loan in full the Borrower will [the Borrower and the partners hereby bind and oblige themselves jointly and severally to +**] pay to the Lender interest on the Loan or on any part or parts of it for the time being remaining due under this Agreement such interest to be calculated and to be payable as provided below.

[Enter details of interest calculations and manner and time of payments. The rate of interest is not to exceed an annual rate of five per cent. above the London Inter-Bank Offered Rate for deposits of the currency in question for the relevant interest period or (where a fixed rate of interest is charged) give per cent. per annum above such rate at the date the Loan is first taken out.]

4. REPAYMENT OF THE LOAN

- (1) The provisions of this paragraph are subject to the provisions of paragraph 5.
- (2) Except where the Borrower has obtained FSA’s prior written consent and that consent has not been withdrawn, **no** repayment or prepayment of the Loan shall be made, in whole or in part, earlier than a date:
 - (a) not less than [five years] [two years] from the date on which the Loan was first made; or

- (b) not less than [five years] [two years] from the date on which the Borrower gave notice in writing to the Lender and FSA, or
 - (c) not less than [five years] [two years] from the date on which the Lender gave notice in writing to the Borrower and FSA.
- (3) If default is made for a period of 7 days or more in the payment of any principal due in respect of the Loan or for a period of 14 days or more in the payment of any interest due in respect of the Loan the Lender may, in order to enforce payment, at its discretion and after taking such preliminary steps as may be necessary and after notifying FSA, institute proceedings for the Insolvency of the Borrower [or the Insolvency of all or any Partners**]. If an order is made or an effective resolution is passed for the winding up of the Borrower, the Loan shall become repayable.
- (4) The Lender may at its discretion, subject to the provisions which follow, institute proceedings for the Insolvency of the Borrower [or the Insolvency of all or any Partners**] to enforce any obligation, condition or provision binding on the Borrower [or on all or any Partners**+] under this Agreement (other than any obligation for the payment of principal moneys or interest in respect of the Loan) provided that the borrower [or any Partner**] shall not by virtue of the institution of any such proceedings be obliged to pay any sum or sums sooner than the same would otherwise have been payable by it. The Lender may only institute such proceedings to enforce the obligations referred to above if (i) the default is not remedied to the satisfaction of the Lender within 60 days after notice of such default is not remedied to the satisfaction of the Lender within 60 days after notice of such default has been given to the Borrower by the Lender (with a copy to FSA) requiring the default to be remedied and (ii) the Lender has taken all preliminary steps required to be taken by it prior to the institution of such proceedings.
- (5) No remedy against the Borrower [or any Partner**] other than as specifically provided by this paragraph shall be available to the Lender whether for the recovery of amounts owing under this Agreement or in respect of any breach by the Borrower [or any Partners**] of any of its obligations under this Agreement.

5. SUBORDINATION

- (1) Notwithstanding the provisions of paragraph 4, the rights of the Lender in respect of the Subordinated Liabilities are subordinated to the Senior Liabilities and accordingly payment of any amount whether principal (by way of repayment or prepayment), interest or otherwise, of the Subordinated Liabilities is conditional upon:-
 - (a) (if an order has **not** been made or an effective resolution passed for the Insolvency of the Borrower) the Borrower being in compliance with its Financial Resource Requirement prevailing at the time of payment by the Borrower; and accordingly no such amount which would otherwise

fall due for payment shall be payable except to the extent that repayment under paragraph 4(2) above is permitted and the Borrower could make such payment and still be in compliance with its Financial Resource Requirement immediately thereafter; and

- (b) (if an order has been made or an effective resolution has been passed for the Insolvency of the Borrower [or if the Borrower shall be dissolved**]) the Borrower being solvent at the time of payment by the Borrower; and accordingly no such amount which would otherwise fall due for payment shall be payable except to the extent that the Borrower could make such payment and still be solvent immediately thereafter. For the purposes of this sub-paragraph, the Borrower shall be solvent if it is able to pay its debts in full and in determining whether the Borrower is solvent for the purposes of this sub-paragraph there shall be disregarded obligations which are not payable or capable of being established or determined in the Insolvency of the Borrower.
- (2) (a) No payment of the Subordinated Liabilities (other than in respect of interest) shall be made at any time under sub-paragraph (1) above unless the Borrower has obtained FSA's prior written consent to such payment and that consent has not been withdrawn.
 - (b) The Borrower shall give or ensure that there are given to FSA such information and auditor's certificate in relation to the proposed payment as FSA may require.
- (3) Payments of interest at a rate not exceeding the rate provided in paragraph 3 may be made to the extent permitted by sub-paragraph (1) above without prior notification to FSA.
 - (4) For the purposes of sub-paragraph (1)(b) above a report given at any relevant time as to the solvency of the Borrower by its Insolvency Officer, in form and substance acceptable to FSA, shall in the absence of proven error be treated and accepted by FSA, the Lender and the Borrower as correct and sufficient evidence of the Borrower's solvency.
 - (5) If the Lender shall receive from the Borrower [or any Partner**] payment of any sum in respect of the Subordinated Liabilities where repayment is prohibited under paragraph 4(2) or when any of the terms and conditions referred to in sub-paragraphs (1) or (2) above is not satisfied the payment of such sum shall be void for all purposes and [any such sum shall be received by the Lender upon trust to return the same to the Borrower+++] [the Lender shall at any time thereafter be bound to return such sum to the Borrower, or, as the case may be, its Insolvency Officer+] (and any sum so returned shall then be treated for the purposes of the Borrower's obligations under this Agreement as if it had not been paid by the Borrower and its original payment shall be deemed not to have discharged any of the obligations of the Borrower). A request to the Lender for return of any sum under the foregoing provisions of this sub-paragraph (5) shall be in writing and shall be made by or on behalf of the Borrower or, as the case may be, its Insolvency Officer.

6. UNDERTAKINGS OF BORROWER

From and after the date of this Agreement (or the Effective Date if earlier), the Borrower will not [and no Partner will**] without the prior written consent of FSA:-

- (1) secure all or any part of the Subordinated Liabilities;
- (2) redeem, purchase or otherwise acquire any of the Subordinated Liabilities;
- (3) amend any document evidencing or providing for the Subordinated Liabilities;
- (4) repay any of the Subordinated Liabilities otherwise than in accordance with the terms of this Agreement;
- (5) take or omit to take any action whereby the subordination of the Subordinated Liabilities or any part of them to the Senior Liabilities might be terminated, impaired or adversely affected.

7. DOCUMENTATION

This Agreement forms the entire agreement as to the Subordinated Liabilities. If there are any other terms relating to the Subordinated Liabilities existing at the date of this Agreement and not comprised in it such terms shall be of no further force and effect. No variation of or amendment to this Agreement shall be of any effect unless it is in writing signed by all the parties. Any amendment to this Agreement made or purported to be made without the consent of FSA shall be void. For the avoidance of doubt, nothing in this paragraph requires the FSA to be a party to this agreement.

8. UNDERTAKINGS OF LENDER

The Lender will not without the prior written consent of FSA:-

- (1) assign or purport to assign to any person the whole or any part of the Subordinated Liabilities;
- (2) purport to retain or set-off at any time any amount payable by it to the Borrower [or any Partner**] against any amount of the Subordinated Liabilities except to the extent that payment of such amount of the Subordinated Liabilities would be permitted at such time by this Agreement, and the Lender shall immediately pay an amount equal to any retention or set-off in breach of this provision to the Borrower and such retention or set-off shall be deemed not to have occurred;
- (3) amend or waive the terms of any document evidencing or providing for the Subordinated Liabilities;
- (4) attempt to obtain repayment of any of the Subordinated Liabilities otherwise than in accordance with the terms of this Agreement;

- (5) take or omit to take any action whereby the subordination of the Subordinated Liabilities or any part of them to the Senior Liabilities might be terminated, impaired or adversely affected;
- (6) take or enforce any security, guarantee or indemnity from any person for all or any part of the Subordinated Liabilities, and the Lender shall, upon obtaining security, guarantee or indemnity in breach of this undertaking, hold the same [on trust for +++] [as agent of and for the benefit of ++] the Borrower.

[Note: Before giving its consent to a transaction falling under paragraph 8(6), FSA will need to be satisfied that the provider of security has waived his rights of subrogation against the Borrower until all Senior Liabilities of the Borrower have been paid in full.]

9. [This Agreement shall subsist in full force and effect notwithstanding any change which may take place from time to time in the constitution or title of the Borrower by the retirement of the present partners or [either] [any] of them or the assumption of new Partners or by a change of name it being provided that:-
 - (a) a retired Partner shall continue to be liable for the payment of all sums due under this Agreement and implementation of all other obligation contained in it until such time as the Lender and the remaining Partner[s] shall agree in writing to release a retired Partner from such obligations and FSA has given its written consent to the release; and
 - (b) in the event of a new partner being assumed as a Partner of the Borrower the other partners shall procure that the said assumed Partner shall become bound to the Lender as a party to this Agreement and shall execute such addendum to it as the Lender and FSA may consider necessary.

The obligations and undertakings of the Borrower under this Agreement shall bind the Borrower and the Partners jointly and severally. **+]

10. LAW [AND JURISDICTION]

- (1) This Agreement is governed by [English law +++++] [the law of Scotland +] [the law of Northern Ireland +++++] and, for the benefit of FSA solely, each of the Borrower and the Lender irrevocably submits to the jurisdiction of the [English Courts +++++] [Court of Session, Scotland +] [Northern Irish Courts +++++] (and, to the extent that it does not have a place of business within this jurisdiction, appoints [*name and address of agent for service*] as agent for receipt of service of process in such courts). Such jurisdiction shall be non-exclusive except to the extent that such non-exclusivity prejudices the submission to such jurisdiction.
- (2) Although not a party to the agreement, the FSA may in its own right enforce a term of the agreement to the extent that it purports to confer upon the FSA a benefit.

IN WITNESS whereof the parties hereto have duly executed this Agreement as a Deed the day and year first above written.

(EXECUTED AS A DEED and DELIVERED by
(the Lender
(and signed by:

Director

Director/Secretary

or

(SIGNED and DELIVERED as a DEED
by the individual partners of the Lender
(as such partners and as individuals
(in the presence of:

or

SIGNED and DELIVERED as a DEED by
the Lender (*if an individual*)
in the presence of:

(EXECUTED AS A DEED and DELIVERED by
(the Borrower
(and signed by:

Director

Director/Secretary

or

(SIGNED and DELIVERED as a DEED
(by the individual partners or the Borrower
(as such partners and as individuals
(in the presence of:

or

*SIGNED and DELIVERED as a DEED by
the Borrower (if an individual)
in the presence of:*

Dated this day of 20

BETWEEN

the Lender

and

the Borrower

**SUBORDINATED
LOAN AGREEMENT**
