

SUPERVISION MANUAL (GUIDANCE AMENDMENT NO 1) INSTRUMENT 2004

Powers exercised

- A. The Financial Services Authority makes this instrument in the exercise of the power in section 157(1) (Guidance) of the Financial Services and Markets Act 2000.

Commencement

- B. This instrument comes into force as follows:
- (1) Annexes A and B come into force on 1 June 2004; and
 - (2) Annex C comes into force on 14 January 2005.

Amendments to the Supervision manual

- C. The Supervision manual is amended in accordance with Annexes A and C to this instrument.

Amendments to the Glossary

- D. The Glossary is amended in accordance with Annex B to this instrument.

Citation

- E. This instrument may be cited as the Supervision Manual (Guidance Amendment No 1) Instrument 2004.

By order of the Board
20 May 2004

Amended by Addendum
17 August 2004

Annex A

Amendments to the Supervision manual

In this Annex, underlining indicates new text and striking through indicates deleted text.

SUP 16 Annex 2G: Guidance notes on completion of banks' reporting forms (including validations)

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BSD3 REPORTING INSTRUCTIONS

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A610 Subordinated term debt

Report here the amount of subordinated term debt (i.e. the amount of principal outstanding before amortisation) which has been approved by the FSA as qualifying for inclusion in Tier 2 capital under the terms of Chapter CA (Definition of capital), Sections 7 and 8, of the FSA Policy Guide/IPRU (BANK) (see item A790). This item should equal the ~~sum of items A790.21 column "Sterling equivalent", A790.22 column "Sterling equivalent" and A790.1~~ amount of principal outstanding converted to sterling at the current exchange rate for the currency concerned on the day of the report unless, via a subordinated swap or some other hedging mechanism that is an integral part of the original preference share or subordinated loan stock agreement, the exchange rate has effectively been fixed - in which case that fixed rate may be used. The reporting institution should obtain the FSA's agreement before doing this.

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FORM BSD3 – CAPITAL ADEQUACY RETURN

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SECTION A: BANKING BOOK

INTERNAL VALIDATIONS

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Ref No	Item Number	
...	...	
70	A623	= (AS790.21+AS790.22) - (AA790.21+AA790.22) <u>Withdrawn July 2004</u>

...

FORM BSD3 – SECTION B: TRADING BOOK FOR SOLO BANK AND LINE BY LINE CONSOLIDATED ENTRIES

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APPENDIX B-IV VALIDATIONS

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Ref No	Appx B-IV Item No	
...	...	
37	A110	= S110 - C110 if positive, else zero <u>Introduced March 2004 Replaced by validation 44 July 2004</u>
38	A120	= S120 - C120 if positive, else zero <u>Introduced March 2004 Replaced by validation 45 July 2004</u>
39	W120	= 10% x (S120 - C120) if positive, else zero <u>Introduced March 2004 Replaced by validation 46 July 2004</u>

40	A130	= S130 – C130 if positive, else zero Introduced March 2004 <u>Replaced by validation 47 July 2004</u>
41	W130	= 20% x (S130 – C130) if positive, else zero Introduced March 2004 <u>Replaced by validation 48 July 2004</u>
42	A140	= S140 – C140 if positive, else zero Introduced March 2004 <u>Replaced by validation 49 July 2004</u>
43	W140	= S140 – C140 if positive, else zero Introduced March 2004 <u>Replaced by validation 50 July 2004</u>
44	A110	= C110 – S110 if positive, else zero Introduced July 2004
45	A120	= C120 – S120 if positive, else zero Introduced July 2004
46	W120	= 10% x (C120 - S120) if positive, else zero Introduced July 2004
47	A130	= C130 – S130 if positive, else zero Introduced July 2004
48	W130	= 20% x (C130 – S130) if positive, else zero Introduced July 2004
49	A140	= C140 – S140 if positive, else zero Introduced July 2004
50	W140	= C140 – S140 if positive, else zero Introduced July 2004
...	"	

Large Exposures (Form LE3) Exposure categories

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PART 3

This covers total exposures to banks¹¹ (or groups of closely related banks), irrespective of the ~~original~~ maturity of the exposure(s), where the exposure has equalled or exceeded 10% of the LECB in the reporting period.

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PART 4

This covers exposures to banks where the (~~original~~) maturity is 1 year or less. You should show exposures to groups of closely related bank counterparties in total.

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Liquidity Return (Form LR)

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Off balance sheet cashflows

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60 Convertible debt securities should be treated as equities where:

- i) the first date at which conversion may take place is less than three months ahead, or the next such date (where the first has passed) is less than a year ahead; and
- ii) the convertible debt security is trading at a premium of less than 10%, where the premium is defined as the current mark-to-market value of the convertible debt security less the mark-to-market value of the underlying equity, expressed as a percentage of the mark-to-market value of the underlying equity.

Convertible debt securities other than those defined above may be treated as equity or debt securities.

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Supervisory Guidance Notes (SGN)

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Appendix D

Central banks (central monetary institutions)

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Middle East oil exporting countries

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Iraq Central Bank of Iraq

Kuwait Bank al-Kuwayt al-Markazi

Central Bank of Kuwait

Kuwait Investment Authority

~~Kuwait Investment Office (London) — regard as non-resident~~

~~Government of Kuwait: Ministry of Finance~~

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Annex B

Amendments to the Glossary

In this Annex underlining indicates new text and striking through indicates deleted text.

EEA State

(in accordance with paragraph 8 of Schedule 3 to the *Act* (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~~ 1 May 2004, the following are the *EEA States*: Austria, Belgium, Cyprus, ~~the Czech Republic~~, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Italy, Latvia, Liechtenstein, Lithuania, Luxembourg, Malta, the Netherlands, Norway, Poland, Portugal, the Slovak Republic, Slovenia, Spain, Sweden, and the *United Kingdom*.

European Economic Area

the area established by the agreement on the European Economic Area signed at Oporto on 2 May 1992, as it has effect for the time being, and which consists of the *EEA States*.

Annex C

Amendments to the Supervision manual

In this Annex, underlining indicates new text and striking through indicates deleted text. Where an entire section of text is being deleted or inserted, the place where the change will be made is indicated and the text is not struck through or underlined.

13.9 ~~[deleted] How does the Handbook apply to branches and cross-border services?~~

Delete the text in section 13.9 'How does the Handbook apply to branches and cross-border services?'

...

Appendix 3.2
Purpose

Delete existing text in *SUP* Appendix 3.2 and insert following text as the new *SUP* Appendix 3.2:

3.2 Purpose

3.2.1 G The purpose of this appendix is to give *guidance*:

- (1) to *UK firms* on some of the issues that arise when carrying on *passported activities* (see *SUP* App 3.5 and *SUP* App 3.6);
- (2) to all *firms* on the relationship between *regulated activities* and activities passported under the *Single Market Directives* (see *SUP* App 3.9 and *SUP* App 3.10).

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3.3.1 G (1) The European Community Treaty (the '*Treaty*'), as amended by later Treaties, established in EC law the rights of freedom of establishment and freedom to provide services in the European Community.

- (2) The *Treaty* lays down central principles governing the legal framework for freedom of establishment and the free movement of services in the European Community. There are, however, a number of areas where the legal position is not clear. This includes, for example, identifying whether a service is provided through an establishment, where the issues involved are complex. Therefore, this Appendix is intended to provide *guidance* but cannot be regarded as comprehensive. Ultimately, the construction of the *Treaty* and relevant Directive provisions is a matter for the European Court of Justice.

3.3.2 G The *Treaty* provides the framework for the provision of banking, ~~insurance and investment business~~, insurance business, investment business, UCITS management services and insurance mediation, while the *Single Market Directives* clarify the rights and freedoms within that framework.

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- 3.3.6 G (1) The European Commission has not produced an interpretative communication on the *Investment Services Directive*. It is arguable, however, that the principles in the communication on the Second Banking Directive can be applied to *investment services*. This is because article 11 of the *Investment Services Directive* (containing provisions relating to conduct of business rules) also applies to the *investment services* of *firms* operating under the *Banking Consolidation Directive*.
- (2) The European Commission has not produced an interpretative communication on either the *Insurance Mediation Directive* or on the *UCITS Directive*.

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Notification of establishing a branch or of providing cross border services

- 3.3.13 G The *Single Market Directives* require *credit institutions, insurance undertakings, investment firms, UCITS management companies* and *insurance intermediaries* to make a notification to the *Home State* before establishing a *branch* or provide *cross border services*.

SUP 13.5 (Notices of intention) sets out the notification requirements for a *firm* seeking to establish a *branch* or provide *cross border services*. As *firms* will note, the decision whether a passport notification needs to be made will be a matter of interpretation. The onus is on *firms* to comply with the requirements of the *Act* and, where relevant, the laws of other *EEA States*. So, in cases of doubt, *firms* should obtain their own legal advice on the specific issues involved.

- 3.3.14 G Blanket notification is the practice of the *Home State regulator* notifying all *Host State regulators* in respect of all activities regardless of any genuine intention to carry on the activity. This practice is discouraged by the *FSA*. However, a *firm* may be carrying on activities in the *United Kingdom* or elsewhere in a way that necessarily gives rise to a real possibility of the provision of services in other *EEA States*. In such cases, the *firm* should consider with its advisers whether it should notify the relevant authorities and include that possibility in its business plan.

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Delete SUP App 3.4 and SUP App 3.5 in their entirety.

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Delete SUP App 3.6.4 in its entirety.

- 3.6.4 G [deleted]

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- 3.6.8 G The *FSA* is of the opinion that *UK firms* that are *credit institutions* and *ISD investment firms* should apply the 'characteristic performance' test (as referred to in ~~AUTH 3.6.7G~~ SUP App 3.6.7G) when considering whether prior notification is

required for services business. *Firms* should note that other *EEA States* may take a different view. Some *EEA States* may apply a solicitation test. This is a test as to whether it is the consumer or the provider that initiates the business relationship.

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Delete *SUP* App 3.6.12G, 3.6.13G, and 3.6.14G in their entirety.

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Delete *SUP* App 3.6.16G to 3.6.24G in their entirety.

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Delete *SUP* App 3.6.28G to 3.6.31G in their entirety.

Delete *SUP* App 3.7 and *SUP* App 3.8 in their entirety.

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3.9 Mapping of the Investment Services Directive ~~and~~ Banking Consolidation Directive, UCITS Directive and Insurance Mediation Directive to the Regulated Activities Order

3.9.1 G The following Tables 1 ~~and 2~~, 2, 2A and 2B provide an outline of the *regulated activities* and *specified investments* that may be of relevance to *firms* considering undertaking *passported activities* under the *Banking Consolidation Directive* ~~or~~ the *Investment Services Directive*, the UCITS Directive and the Insurance Mediation Directive. The tables may be of assistance to *UK firms* that are thinking of offering financial services in another *EEA State* and to *EEA firms* that may offer those services in the *United Kingdom*.

3.9.2 G The tables provide a general indication of the *investments* and activities specified in the *Regulated Activities Order* that may correspond to categories provided for in ~~either~~ the *Banking Consolidation Directive* ~~or~~ the *Investment Services Directive*, the UCITS Directive or the Insurance Mediation Directive. ~~The guidance does not cover the UCITS Directive~~. The tables do not provide definitive *guidance* as to whether a *firm* is carrying on an activity that is capable of being *passported*, nor do the tables take account of exceptions that remove the effect of articles. Whether a *firm* is carrying on a *passported activity* will depend on the particular circumstances of the *firm*. If a *firm's* activities give rise to potential *passporting* issues, it should obtain specialist advice on the relevant issues.

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3.9.4 G Table: Activities set out in Annex I of the BCD

Table 1: BCD activities		Part II RAO Activities	Part III RAO Investments
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14.	Safe custody services	Article 64	Article 76-81, 83-85, 89
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3.9.5 G Table: Services set out in Annex to the ISD

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3.9.6 G Table: Activities set out in Article 5(2) and (3) of the UCITS Directive

<u>Table 2A: UCITS Directive activities</u>		<u>Part II RAO Activities</u>	<u>Part III RAO Investments</u>
<u>1.</u>	<u>The management of UCITS in the form of unit trusts / common funds or of investment companies; this includes the functions mentioned in Annex II of the UCITS Directive (see Note 2).</u>	<u>Article 14, 21, 25, 37, 51, 53, 64</u>	<u>Article 76-81, 83-85, 89</u>
<u>2.</u>	<u>Managing portfolios of investments, including those owned by pension funds, in accordance with mandates given by investors on a discretionary, client-by-client basis, where such portfolios include one or more of the instruments listed in Section B of the Annex to the ISD.</u>	<u>Article 14, 21, 25, 37, 53, 64</u>	<u>Article 76-81, 83-85, 89</u>
<u>3.</u>	<u>Investment advice concerning one or more of the instruments listed in Section B of the Annex to the ISD.</u>	<u>Article 53, 64</u>	<u>Article 76-81, 83-85, 89</u>
<u>4.</u>	<u>Safekeeping and administration services in relation to units of collective investment undertakings.</u>	<u>Article 40, 45, 64</u>	<u>Article 76-81, 83-85, 89</u>

Note 1. A UCITS management company can only exercise passport rights under the UCITS Directive (article 2(2)(h) of the ISD). A UCITS management company can only be authorised to carry on the non-core services set out in rows (3) and (4) of Table 2A if it is also authorised to carry on the activity set out in row (2) of the table.

Note 2. The functions set out in Annex 2 to the UCITS Directive are:

1. Investment management.

2. Administration:
 - a. legal and fund management accounting services;
 - b. customer inquiries;
 - c. valuation and pricing (including tax returns);
 - d. regulatory compliance monitoring;
 - e. maintenance of unit-holder register;
 - f. distribution of income;
 - g. unit issues and redemptions;
 - h. contract settlements (including certificate dispatch);
 - i. record keeping.
3. Marketing.

3.9.7

G

Table: Activities set out in Article 2(3) of the IMD

<u>Table 2B: IMD activities</u>		<u>Part II RAO Activities</u>	<u>Part III RAO Investments</u>
<u>1.</u>	<u>Introducing, proposing or carrying out other work preparatory to the conclusion of contracts of insurance.</u>	<u>Articles 25, 53 and 64</u>	<u>Article 75, 89 (see Note 1)</u>
<u>2.</u>	<u>Concluding contracts of insurance</u>	<u>Article 21, 25, 53 and 64</u>	<u>Article 75, 89</u>
<u>3.</u>	<u>Assisting in the administration and performance of contracts of insurance, in particular in the event of a claim.</u>	<u>Article 39A, 64</u>	<u>Article 75, 89</u>

Note 1. Rights to or interests in *life policies* are *specified investments* under Article 89 of the *Regulated Activities Order*, but rights to or interests in *general insurance contracts* are not.

ADDENDUM

SUPERVISION MANUAL (GUIDANCE AMENDMENT NO 1) INSTRUMENT 2004

The cover sheet of this instrument, as adopted by order of the Board on 20 May 2004, is amended by the insertion of the underlined text and the deletion of the strikethrough text. For the sake of clarity, and following the adoption of the addendum, this amendment will be made to the cover sheet without showing the change.

Commencement

B. This instrument comes into force as follows:

- (1) Annexes A and B come into force on 1 June 2004; and
- (2) Annex C comes into force on ~~15~~ 14 January 2005.